

PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298



December 29, 2009

TO: ALL PARTIES OF RECORD IN RULEMAKING 09-01-019

Decision 09-12-045 is being mailed without the concurrence of Commissioner Grueneich. The concurrence will be mailed separately.

Sincerely,

/s/ KAREN V. CLOPTON
Karen V. Clopton, Chief
Administrative Law Judge

KVC/jt2

Attachment

Decision 09-12-045 December 17, 2009

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Examine
the Commission's Energy Efficiency
Risk/Reward Incentive Mechanism.

Rulemaking 09-01-019
(Filed January 29, 2009)

**DECISION REGARDING RRIM CLAIMS
FOR THE 2006-2008 PROGRAM CYCLE**

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DECISION REGARDING RRIM CLAIMS FOR THE 2006-2008 PROGRAM CYCLE

1. Introduction

Today's decision authorizes incentive earnings for the achievement of energy efficiency savings during the 2006-2008 program cycle pursuant to the Risk/Reward Incentive Mechanism (RRIM). As established in Decision (D.) 07-09-043, the RRIM offers the four major California energy utilities (i.e., Pacific Gas and Electric Company (PG&E), Southern California Edison Company (SCE), San Diego Gas & Electric Company (SDG&E), and Southern California Gas Company (SoCalGas or SCG) ("the utilities")) incentives to achieve or surpass Commission-adopted energy efficiency goals, and to extend California's commitment to making energy efficiency the highest energy resource priority. Incentives are earned in relation to each utility's success in achieving Commission-adopted energy savings goals.¹

Under the mechanism, each utility is eligible for incentives during three-year program cycle, payable in annual installments, with two interim payments, and a final true-up after the program cycle ends. In December 2008, PG&E, SCE, SDG&E, and SoCalGas each were authorized a first installment of RRIM earnings for the 2006-2007 mid-cycle performance.² In this decision, we resolve remaining RRIM issues for the 2006-2008 program cycle. We hereby

¹ In D.05-09-043 and D.05-11-011, we approved utility program portfolios to procure energy efficiency savings over the 2006-2008 cycle in the amount of \$2.2 billion of ratepayer funds.

² The first installment of interim awards for 2006-2007 were in the amounts of \$41.5 million, \$24.7 million, \$10.8 million, and \$5.2 million, for PG&E, SCE, SDG&E, and SoCalGas respectively.

authorize a second installment of interim RRIM awards for the 2006-2008 program cycle in the following amounts:

Adopted Second Installment of Interim RRIM Earnings

Utility	Earnings Authorized in D.08-12-059 [A]	Earnings Rate	Maximum Earnings (PEB * Earnings Rate) [B]	Maximum Earnings less 35% holdback [C]	2nd Installment of Interim Earnings [C]-[A]	Holdback Amount Subject to Final True-up [B] - [C]
PG&E	\$41,500,000	12%	\$115,277,868	\$74,930,614	\$33,430,614	\$40,347,254
SCE	\$24,700,000	12%	\$77,465,151	\$50,352,348	\$25,652,348	\$27,112,803
SDG&E	\$10,800,000	12%	\$17,077,803	\$11,100,572	\$300,572	\$5,977,231
SCG	\$5,200,000	12%	\$11,247,724	\$7,311,021	\$2,111,021	\$3,936,703

Consistent with prior practice, we hold back 35% of total incentive earnings pending a final true-up in 2010. The incentive earnings authorized are based upon independently verified utility savings achieved, as set forth in the Energy Division Second Verification Report, applying the formulas adopted in D.07-09-043. To arrive at the authorized earnings figures set forth above, we include both positive and negative interactive effects, and apply additional adjustments to the calculations set forth in the Verification Report: (1) We exclude the cumulative effects of 2004-2005 savings goals which were included in the Verification Report figures; (2) We adjust the savings goals in the Verification Report to recognize interactive effects that were not originally considered in setting 2006-2008 goals; and (3) We adjust the shared savings rate to 12% based on the use of the utilities' proposed unmodified ex ante assumptions in comparing the utilities' results with the Commission goals; (4) We adjust the Net to Gross ratio for SCE's residential lighting program to reflect SCE's specific implementation approach to this program; (5) We adjust the realization rate applied to SDG&E's Energy Savings BID program and SoCal

Gas' Local Business Energy Efficiency program to reflect the unique nature of those programs as compared to more generic statewide programs. As discussed below, we decline to rely upon the Proposed Settlement offered in this proceeding, or upon self-reported claims of SCE as a basis for determining the applicable incentive awards.

We opened this proceeding, recognizing the contentious character of the predecessor proceeding in determining the applicable RRIM earnings. The Energy Division's First Verification Report, covering 2006 and 2007 activities, became controversial due both to delays and to disputes about the parameter values used in calculating incentive payments. These controversies illustrate that the RRIM methodologies are complex and not as easily or as timely resolved as had been originally contemplated.

In opening this proceeding, we sought to develop a new framework for the interim review of 2008 energy efficiency activities and the final review of 2006 through 2008 energy efficiency activities (now set for 2010).³ The assigned Commissioner thus directed parties to engage in settlement discussions on 2006-2008 RRIM disputes. Although parties entered into settlement discussions, the resulting efforts did not produce an acceptable solution. Individual parties either maintained their pre-settlement positions, or entered into a settlement that failed to produce a fair and balanced outcome.

We continue to believe that prospectively, reforms to the existing mechanism should be pursued that reasonably produce meaningful incentives to achieve the Commission's energy efficiency goals through simplified approaches

³ Order Instituting Rulemaking (OIR) 09-01-019 at 5.

designed to avoid the level of controversy over detailed technical methodologies that have characterized the RRIM process to date.

Based on the record before us, the appropriate course is to award interim year-end incentive earnings based on independently verified and up-to-date performance measures. Neither the Proposed Settlement nor the SCE proposal incorporates independently verified measures. Instead, independently verified performance results are found in the Energy Division's Second Verification Report. Accordingly, we rely upon data verified in that Report as the basis for the second installment of interim incentives. We do so, recognizing that the earnings are interim, with a provision for a subsequent final true-up in 2010. In that context, the adopted incentives are appropriate in view of the risks and benefits involved.

We also establish a schedule and process for a 2010 true-up of final incentive awards for the 2006-2008 period. With the interim incentive payments and process for true-up next year, we balance the goals of promoting energy efficiency achievements while protecting ratepayers from over paying for incentives that have not been earned. We also encourage parties to enter into further settlement discussions on 2010 true-up amounts that reasonably tie incentives to performance consistent with the principles set forth in this decision, but without the necessity to litigate all of the detailed calculations required by the Final Performance Basis Report.

2. Background

As a context for assessing incentive awards, we review the Risk/Reward Incentive Mechanism (RRIM) framework as established and subsequently modified in Rulemaking (R.) 06-04-010, the predecessor to this rulemaking.

As adopted in Decision (D.) 07-09-043, RRIM awards are determined by applying a “minimum performance standard” (MPS) and “performance earning basis” (PEB). The utility must achieve an MPS at least between 80%-85% of Commission-adopted savings goals to be eligible for incentive rewards. No incentive earnings or penalties accrue within a "deadband range," (i.e., above 65% and below 85% of the savings goals). A penalty applies if performance falls below this threshold.

The PEB measures the net resource benefit created by the utility’s deployment of energy efficiency measures. The incentive reward equals the product of the PEB multiplied by a “shared savings rate” related to the applicable degree of goal achievement. Total incentive earnings and penalties are capped at \$450 million for the 2006-2008 cycle for the four utilities combined.

In D.07-09-043, we recognized “that an effective incentive mechanism must include provisions for earnings (or penalties) at interim points during the three-year program cycle, as opposed to waiting nearly five years after portfolio implementation for any financial feedback to utility managers and investors.”⁴ We thus established a process for submission, review and payout of annual interim incentive claims in the first and second years of the three-year program cycle to provide timely feedback on utility performance in achieving energy efficiency savings.⁵ Interim RRIM claims were to be based on *ex ante* savings estimates subject to a holdback of a portion of the total claim, pending *ex post* true-up.

⁴ D.08-01-042, citing D.07-09-043 Conclusion of Law 7 at 212.

⁵ See D.07-09-043, Conclusion of Law 7 at 212, and Attachments 6 and 7.

Independent verification of claimed savings is essential to ensure that incentives are awarded in relation to real savings achieved, and that customers fund incentives only for savings that are real and verified. In D.05-01-055, we mandated that the Energy Division take responsibility for managing and contracting for all evaluation, measurement and verification (EM&V) studies. Among other purposes, the Energy Division studies served as the basis for RRIM earnings, based upon independent verification of energy savings achieved and installations completed using adopted protocols.⁶

2.1. Modifications in the RRIM Adopted in D.08-01-042

In January 2008, we adopted modifications in the RRIM pursuant to Petitions for Modification of D.07-09-043,⁷ filed October 31, 2007. The utilities argued that the effectiveness of the RRIM would be diluted if interim earnings could be refunded via a true-up.⁸ This risk was further pronounced by the “all-or-nothing” nature of the RRIM formula whereby a small change in goal achievement could eliminate interim incentives. The utilities argued that under generally accepted accounting treatment, interim incentive awards subject to possible refund would not be counted as “regular earnings.” The inability to book incentives as “regular earnings” meant they would not factor into the utility's financial valuation, thus diluting the potential incentive value as an earnings enhancement. The utilities argued that it would defeat the purpose of

⁶ D.07-09-043 at 4.

⁷ Petition for Modification of Decision 07-09-043 By Pacific Gas And Electric Company, Southern California Edison Company, San Diego Gas & Electric Company And Southern California Gas Company, filed October 31, 2007 and amended November 7, 2007 (First PFM).

⁸ D.08-01-042 at 9-10.

the RRIM to subject them to the "all or nothing" forecasting uncertainty associated with the true-up. The utilities thus sought to eliminate the possibility of a refund of interim RRIM earnings as a result of a true-up, and to use only *ex ante* estimates rather than final load impact studies.⁹

In D.08-01-042, in response to the Petitions, the Commission agreed that the utilities would likely be unable to book authorized interim earnings during the program cycle as "regular earnings" without a change to the true-up provisions. The Commission determined not to require the utilities to refund interim incentive earnings except where *ex post* review indicated that performance fell within the penalty band. Under such circumstances, interim incentive earnings would be refunded in addition to any penalties owed. If the *ex post* review indicated that utility performance fell within the "deadband," the utility would still earn incentives, applied to *ex post* results.¹⁰

These changes reduced investor-owned utility (IOU) risks relating to *ex post* review and true-up, but also increased ratepayers' risks of incentive overpayment. To mitigate the risk of large swings between interim and final earnings, the Commission increased the amount of the interim payment to be held back for the final true-up from 30% to 35%. As an additional precaution, the Commission called for a mid-cycle updating of the Database for Energy Efficient Resources (DEER) *ex ante* load impacts as a basis for payout of interim claims in 2008 and 2009.¹¹ The DEER was jointly developed with input and support from the IOUs and other stakeholders, and is designed to be the primary

⁹ D.08-01-042 at 4.

¹⁰ D.08-01-042, Ordering Paragraph 2.

¹¹ D.08-01-042, Finding of Fact 15 at 21.

source for energy savings and cost-effectiveness assumptions for program planning. The EM&V protocols call for the updating of DEER on a regular basis.¹² The combination of updated *ex ante* values combined with a larger holdback (increased from 30% to 35%) was intended to substantially mitigate ratepayer risk resulting from the modified true-up provisions.¹³

2.2. Further Modifications in the RRIM Adopted in D.08-12-059

The mandate in D.08-01-042 for the DEER update during the middle of a three-year cycle had the unintended effect of significantly increasing workload demands on the Energy Division. The added workload had not been anticipated in the original Verification Report schedule. Originally, the Verification Reports were to be released in August following the end of each program year.¹⁴ Given the expanded mandate, the Energy Division required additional time to complete its Verification Report, together with updates to DEER *ex ante* assumptions.

¹² DEER parameters include Net-to-Gross Ratios, Effective Useful Life, and Unit Energy Savings values for standard or “deemed” energy efficiency measures. “Deemed” measures refer to projects and technologies that are relatively simple to analyze and evaluate, and that do not vary tremendously with individual projects. Measures whose performance varies significantly among individual projects are categorized as “custom” measures. (See D.05-04-051, Sec. 3.2.)

¹³ D.08-01-042, Finding of Fact 11 at 20.

¹⁴ See *ALJ Ruling Adopting Protocols for Process and Review of Post-2005 EM&V activities*, January 11, 2006. The annual schedule for Energy Division’s Verification Report was modified for the 2006-2008 program cycle. The verification of 2006 installations and program costs was combined with the report on 2007 accomplishments, so that both were scheduled to be released in August of 2008.

As a result, on August 15, 2008, the utilities filed a Petition for Modification of D.07-09-043 and D.08-01-042, expressing concern that the delay risked the timely receipt of 2006-2007 interim RRIM earnings. The utilities asked that interim incentives for 2006-2007 performance be based on their self-reported claims rather than on the Energy Division Verification Report.

In December 2008, the Commission issued D.08-12-059. Because the Energy Division's first Verification Report would not be available in time to determine year-end 2008 incentive earnings, the Commission awarded interim incentives based on utility self-reported claims.

Because the first installment of interim incentive payments was based on the IOU self-reported claims without independent verification, as required by D.08-01-042, the Commission expressed concerns about the added risk to ratepayers of overpayment. To mitigate this risk, the interim awards were subject to a higher 65% holdback.

The Commission determined that if the Energy Division's Second Verification Report were not completed in time for use in determining the second interim incentive payments (covering 2008 program performance), those incentive payments would be based on the utilities' quarterly savings reports subject to a holdback of at least 65%. The specific holdback was to be determined at the discretion of the assigned Commissioner based on the assessed risk of incentive overpayment. For the 2006-2008 program cycle, the *ex post* true-up provisions were amended such that if utility performance fell within the deadband,¹⁵ the utility would not receive any additional incentive rewards.

¹⁵ The deadband range applies for achievement of savings goals of less than 80% for any individual savings metric or less than 85% for the average savings threshold but

Footnote continued on next page

In D.08-12-059, the Commission also noted the concerns raised concerning the robustness of DEER assumptions and updates thereof used to assess IOU performance.¹⁶ The IOUs associated the delays in the Verification Report with the controversy surrounding the updating of DEER parameters. The utilities thus asked that DEER updates used to evaluate energy efficiency measure and program performance be reviewed by the full Commission rather than being left to the discretion of Energy Division.

In D.08-12-059, the Commission agreed that in view of the controversy involved, the level of review and approval of the DEER updates should be elevated. Accordingly, we adopted a requirement in D.08-12-059 that the Energy Division Verification Report be issued:

via draft resolution for consideration and adoption by the Commission before those reports are used to determine incentive payments or penalties under the RRIM.¹⁷

The Commission opened this proceeding as the successor to R.06-04-010, and suspended the previous schedule for verification and review of 2006-2008 energy efficiency incentive claims. The new rulemaking was to allow for consideration of a new framework for the review of the remainder of 2006-2008 energy efficiency activities in a time frame consistent with interim payments for

greater than 65% of the Commission's goal for each individual metric energy savings and demand reductions.

¹⁶ On October 28, 2008, an assigned Commissioner Ruling in R.06-04-010 took Judicial Notice of the Final DEER 2006-2007 Measure Updates, as well as all comments and Energy Division responses in the process leading up to final adoption of the updates, thereby incorporating this information into the record of R.06-04-010.

¹⁷ See D.08-12-059 at 21.

2008 no later than December 2009, and any final payments for 2006 through 2008 no later than December 2010.

A prehearing conference was held in this proceeding on April 7, 2009. By Assigned Commissioner and Administrative Law Judge's Ruling dated April 14, 2009, a schedule and scoping memo was issued. The scope of the proceeding was designated into two major tracks: (1) resolving outstanding disputes as to any incentive earnings due for the 2006-2008 program cycle; and (2) developing prospective policies and rules to improve the RRIM for 2009 and beyond. The instant decision focuses only on the first track, i.e., 2006-2008 issues. A separate decision will address prospective reforms in the RRIM.

The parties actively participating in this portion of the proceeding, in addition to the respondent utilities, were the Division of Ratepayer Advocates (DRA), The Utility Reform Network (TURN), Natural Resources Defense Council (NRDC), and Women's Energy Matters (WEM).

Pursuant to the Assigned Commissioner's Ruling, parties convened a settlement conference for the purpose of seeking agreement on the treatment of remaining outstanding incentive claims for the 2006-2008 cycle. Parties filed pre-settlement position papers on April 29, 2009, on 2006-2008 issues. A settlement conference was convened on May 6, 2009, which was attended by interested parties.

On May 21, 2009, Pacific Gas and Electric Company (PG&E), San Diego Gas & Electric Company (SDG&E), Southern California Gas Company (SoCalGas), and the NRDC jointly filed a motion for approval of a Settlement Agreement on 2006-2008 issues. Comments on the Settlement Agreement were filed on June 12, 2009, with responses on June 22, 2009. PG&E, SDG&E, and SoCalGas each filed supplements to the Proposed Settlement on July 10, 2009,

setting forth the calculations of adjustments to claimed incentive earnings based upon the Settlement. DRA filed comments in response to the supplement on July 28, 2009.

The Energy Division also produced computer model runs based on the Proposed Settlement calculations of incentive amounts, including sensitivities of the Settlement's calculations resulting from changing selected assumptions.

Two parties submitted written testimony on 2006-2008 RRIM issues. Southern California Edison Company (SCE) submitted opening testimony and DRA submitted reply testimony. WEM filed a motion for evidentiary hearings on June 26, 2009. No other party requested hearings or supported the WEM motion. By Administrative Law Judge (ALJ) ruling dated July 8, 2009, the WEM motion for evidentiary hearings was denied, and the SCE and DRA testimonies were received into evidence.

3. Second Installment of Interim Incentive Awards for 2006-2008

Since the IOUs have already received a first interim award covering 2006-2007 program activity, the issue before us in this decision focuses on what, if any, remaining incentive payments should be awarded for the 2006-2008 program cycle. We hereby award a second installment of 2006-2008 interim earnings for those utilities whose performance met or exceeded designated Commission-adopted thresholds. We also establish the process for a final true-up of 2006-2008 incentive payments by the end of 2010.

Any remaining incentive payments for the 2006-2008 cycle will necessarily be authorized and remitted after the associated performance cycle has concluded. Therefore, it is too late for additional incentive payments to motivate program accomplishments that have already occurred. Nonetheless, the utilities

pursued the 2006-2008 programs with the expectation of incentive earnings in accordance with the adopted protocols. The outcome we reach in this decision takes into account the need for maintaining the integrity of program, which means timely payment of incentives for actual achievements while also protecting ratepayers from overpaying for incentives that have not been earned.

Parties' positions on remaining 2006-2008 incentive awards may be categorized as: (1) advocates of the Energy Division Verification Report as the sole basis for any incentive payments, (2) supporters of a Proposed Settlement as described below, and (3) SCE which proposed an award for 100% of its own self-reported RRIM earnings with no true-up. Active parties entered into settlement discussions on 2006-2008 incentive claim disputes, but only PG&E, SDG&E, SoCalGas, and NRDC (the Settling Parties), actually agreed to a settlement.

3.1. The Energy Division Verification Report as the Basis for Determining Interim Incentive Earnings

Parties disagree concerning whether the Commission should consider the results of the Energy Division Verification Report as the basis for determining the second installment of any RRIM earnings awards. For the 2010 true-up, the utilities sponsoring the Proposed Settlement would not oppose the consideration of the Energy Division Verification Report, but only if it is properly vetted, and if there is no delay in the issuance of that Report.

In D.05-01-055, the Commission shifted in the responsibility for overseeing EM&V studies, from the utilities to the Commission's Energy Division. The purpose of the shift was to help ensure unbiased results by having a neutral

entity overseeing the EM&V process.¹⁸ As discussed above, on November 18, 2008 (rather than August 2008 as originally planned), the Energy Division issued its “Energy Efficiency 2006-2007 Verification Report, Review Draft” (First Draft Verification Report).¹⁹ The First Draft Verification Report calculated that the utilities had earned little or no interim incentive awards for 2006-2007 based on installation and expenditure verification and updates to *ex ante* DEER assumptions.²⁰

As noted above, however, the Commission did not rely upon the First Verification Report for awarding the initial installment of incentive earnings for 2006-2007 due to scheduling difficulties. The First Draft Verification Report was thus deemed moot for purposes of 2006-2007 interim incentive payments, although it may be used for other purposes in reviewing utility program performance as well as for future planning.

By ALJ ruling dated July 30, 2009, parties were placed on notice that the Commission, however, may possibly consider the second interim Verification Report as a basis to determine the second installment of 2006-2008 incentives. On August 6, 2009, the Energy Division issued its second interim “Energy

¹⁸ See D.07-09-043 at 131.

¹⁹ The First Draft Verification Report and accompanying appendices consisted of more than 150 pages of detailed analysis explaining the savings parameters used and the rationale for the results.

²⁰ Based on the First Draft Verification Report, SoCalGas would have earned an interim incentive payment of only \$3.6 million. PG&E and SDG&E performance fell in the deadband and would thus not have resulted in any interim incentive payments for them. Based on the Verification Report, SCE’s performance actually called for payment of a \$6.9 million penalty. The Draft Report showed a \$17.8 million penalty for SCE, but this was corrected to \$6.9 million in a November 19, 2008 erratum.

Efficiency Verification Report” in draft form. Comments were filed on the Draft Report and a workshop was convened on September 16, 2009. The Energy Division revised the Draft Report in response to comments. The Commission adopted the final version of second Verification Report by Resolution No. E-4272 on October 15, 2009.

The Energy Division Second Verification Report calculated total 2006-2008 RRIM earnings, and derived a second installment of interim RRIM payments (a) by withholding 35% holdback to the total eligible earnings, and then (b) subtracting interim incentives already granted in D.08-12-059.

The Verification Report depicted incentive earnings under three different scenarios: (a) Without Interactive Effects, (b) With Both Positive and Negative Interactive Effects, and (c) With Positive Interactive Effects Only.

The Second Verification Report computed the following amounts as interim 2009 end-of-year incentive earnings and carryover for the 2010 true-up, based upon savings achieved (both with and without interactive effects recognized).

Energy Division Second Verification Report Calculations of RRIM Earnings

(1)

Without Interactive Effects

Second Verification Report								
Utility	From 1st Verification Report	Authorized in D.08- 12-059	[A]	Earnings Rate	Max Earnings (PEB* Earnings Rate) [B]	Max Earnings less 35% holdback [C]	2nd Interim Earnings [C] - [A]	Holdback Amount Subject to Final True-up [B] - [C]
PGE	\$ -	\$ 41,500,000		0%	-	-	-	-
SCE	-	24,700,000		0%	-	-	-	-
SDGE	-	10,800,000		0%	-	-	-	-
SCG	2,886,293	5,200,000		9%	7,374,572	4,793,472	-	2,581,100

(2)

With Positive-Only Interactive Effects

Second Verification Report								
Utility	From 1st Verification Report	Authorized in D.08- 12-059	[A]	Earnings Rate	Max Earnings (PEB* Earnings Rate) [B]	Max Earnings less 35% holdback [C]	2nd Interim Earnings [C] - [A]	Holdback Amount Subject to Final True-up [B] - [C]
PGE	\$ -	\$ 41,500,000		9%	\$ 95,540,441	\$ 62,101,287	\$ 20,601,287	\$ 33,439,154
SCE	-	24,700,000		9%	60,543,730	39,353,425	14,653,425	21,190,306
SDGE	-	10,800,000		0%	-	-	-	-
SCG	2,886,293	5,200,000		9%	7,374,572	4,793,472	-	2,581,100

(3)

With Both Positive and Negative Interactive Effects

Second Verification Report								
Utility	From 1st Verification Report	Authorized in D.08- 12-059	[A]	Earnings Rate	Max Earnings (PEB* Earnings Rate) [B]	Max Earnings less 35% holdback [C]	2nd Interim Earnings [C] - [A]	Holdback Amount Subject to Final True-up [B] - [C]
PGE	\$ -	\$ 41,500,000		9%	\$ 86,458,401	\$ 56,197,960	\$ 14,697,960	\$ 30,260,440
SCE	-	24,700,000		9%	53,183,505	34,569,278	9,869,278	18,614,227
SDGE	-	10,800,000		0%	-	-	-	-
SCG	2,886,293	5,200,000		9%	7,374,572	4,793,472	-	2,581,100

Based on the Verification Report, SDG&E would not be eligible for a second interim shareholder earnings award for program years 2006-2008, regardless of the data scenario assumed. SoCalGas would not be eligible for a second interim award regardless of the data scenarios since the first interim payment of \$5.20 million authorized in D. 08-12-059 is higher than total

allowable earnings of \$4.79 million calculated in the Verification report. No utility would be eligible for a second interim payment using the “Without-Interactive-Effects” data scenario.

The RRIM earnings calculated in the second Verification Report are higher than in the first Report. In part, this increase can be attributed to the “hockey stick” effect where savings tend to be lower in the first two years, and higher in the third year, as the programs achieve full impact.²¹

3.1.1. Position of Utilities and NRDC on the Energy Division Verification Report

The four utilities and NRDC all object to relying on the Energy Division Second Verification Report, arguing that the Report has not been vetted, contains errors, and does not constitute a reliable basis to determine interim RRIM payments. SCE presented the most extensive objections to relying upon the Report, which are representative of the views of other utilities on the issue. In its prepared testimony, SCE focused criticisms on the first Verification Report, released in final form on February 5, 2009, claiming it did not address or correct the flaws that SCE had previously identified. SCE subsequently filed comments objecting to the Draft Resolution to adopt the Second Verification Report. In its comments on the Second Verification Report, SCE continues to make similar criticisms.

SCE claims that both the First and Second Verification Reports were developed with little input from stakeholders and with no public process. SCE characterizes the methodology underlying the Reports as a “black box” that undermines the transparency needed in an effective earnings mechanism.

²¹ See D.09-09-047 at 29.

SCE claims that the Verification Reports did not adhere to the policies and procedures established to guide the 2006-2008 energy efficiency programs, and that Energy Division did not initiate a collaborative forum with stakeholder input as a basis for its 2008 updated DEER assumptions. SCE claims that the 2008 DEER estimates are flawed and contain unsupportable assumptions with no true vetting process.

SCE claims that the Verification Report is unreliable as a tool to evaluate SCE's energy efficiency achievements in 2006-2007. (SCE Testimony at 16.) In comments on the draft resolution for adoption of the Second Verification Report, SCE claims that while Energy Division did correct a few errors that remained from the first interim report, it ignored or disregarded other errors.²² SCE argues that the second Verification Report continues to rely upon "non-transparent, unvetted, black-box assumptions that do not meet industry best practices or approved methodologies."²³ SCE argues that instead of utilizing the measurement protocols adopted in 2006, and developed over a number of years, the Second Verification Report had little input from stakeholders, and lacks transparency.

SCE also criticizes the Energy Division's Verification Reporting Template (VRT) as untested and unvetted, as a tool created to calculate SCE incentive earnings that went beyond Commission direction, and that contains significant flaws.

²² See SCE Comments dated August 26, 2009 at 2.

²³ *Id.* at 3.

3.1.2. Position of DRA, TURN, and WEM on Use of the Energy Division Verification Report

DRA, TURN, and WEM argue that any RRIM earnings should be determined by the results of the Energy Division Verification Report process. They dispute utility characterizations that the Commission agreed that the Energy Division Verification Report was unreliable as a tool to derive incentive earnings. DRA argues that the Commission merely expressed concern about the timing of the Verification Report, since a final version was not available in time for a year-end 2008 award. The Commission continued to support the use of ex ante updates. DRA also states that the Commission expected that second interim claim was to be based on the 2009 Verification Report subject to public comment via a draft resolution.

TURN also supports use of the Verification Report as the basis for RRIM earnings claims. On the basis of the First Verification Report, TURN contends that PG&E, SCE, and SDG&E were not entitled to interim earnings for 2006-2007 activities.²⁴ Based on the First Verification Report, TURN believes that SoCalGas was eligible for interim payment of approximately \$1.9 million (applying the 35% holdback provision adopted in D.08-01-042 to the \$2.9 million incentive earnings). Since SoCalGas has already collected \$5.2 million pursuant to D.08-12-059, TURN believes that SoCalGas should retain only \$1.9 million, and return to ratepayers the remaining \$3.3 million.

The Commission noted that “Energy Division has encountered delays in the completion of the verification reports and updates” in both D.08-12-059 and

²⁴ TURN and DRA separately filed an application for rehearing of D.08-12-059 alleging that the Commission acted unlawfully in awarding \$82 million to the utilities. TURN appended a copy of its application for rehearing to its comments in this proceeding.

the OIR 09-01-019.²⁵ TURN contends, however, that the Energy Division is not responsible for the process breakdown, but that the “delay” of the 2008 Interim Verification Report was caused by utility intransigence in the face of data predating D.05-09-043 that showed that the savings based on 2005 DEER parameters were grossly inflated and would be significantly reduced with the DEER update. WEM likewise argues that the Settlement fails to acknowledge the potential for the IOUs to contribute to delay in the preparation of the Energy Division Verification Report by not providing timely responses to data requests.

The Interim Verification Report, as originally envisioned in D.07-09-043, was not meant to update DEER values during a three-year program cycle. In D.08-01-042, however, in order to guard against a significant final *ex post* true-up adjustment, the Energy Division was tasked with updating the DEER values before year-end 2008 on an accelerated schedule. In light of this, TURN argues that the four-month delay (from August until November) of the Draft Verification Report is understandable.

DRA argues that using the revised 2008 information could significantly lower the interim claim payments to the utilities.²⁶ DRA contends that each of the revised parameters represents the independent judgment of a non-financially interested party regarding the best estimate of that particular parameter.

²⁵ See, for example, D.08-12-059 at 6.

²⁶ SCE, which is not a party to the proposed settlement, submitted testimony that contends that updating these parameters, with the exception of interactive effects, and with the addition of remaining useful life, would reduce SCE’s claimed customer net benefits of \$1,290 million for its 2006-2008 energy efficiency programs by \$575 million. (Testimony of SCE in Support of its Proposed Resolution of its 2006-2008 Energy Program Cycle Risk/Reward Incentive Claims, submitted May 26, 2009 in R.09-01-019 at 21:1 – 24:2).

DRA notes that if any of those parameters are estimated incorrectly for purposes of the 2009 interim claim, there is an asymmetric risk regarding the error. If the parameters understate energy savings, the utilities will be made whole in the final true-up process. If they overstate the energy savings, however, the utilities will nevertheless keep their interim payments, unless the final impact reports show that their savings were so low that performance fell in the penalty zone established by D.07-09-043.

For the 2008 interim claim, TURN proposes that D.07-09-043 and D.08-01-042 procedures should be followed, with interim claims based on fourth quarter 2008 reports, using ex ante measure savings parameters, including net-to-gross ratios, and expected useful lives from the 2009 DEER update, where available, following release of the second Verification Report. TURN proposes that if Energy Division does not update DEER for 2009, then the ex ante savings parameters in the 2008 DEER update be used for the 2008 interim claim.

3.2. Proposed Settlement as a Basis for Incentive Earnings

3.2.1. Position of Settling Parties

The Settling Parties (i.e., PG&E, SDG&E, SoCalGas, and NRDC) jointly filed a motion for adoption of a Proposed Settlement, which they claim would “reasonably apply the components of the interim claim process for the 2009 claim” and “allow the true-up process to run its course.”²⁷

²⁷ Motion of Pacific Gas and Electric Company, San Diego Gas & Electric Company, Southern California Gas Company and the Natural Resources Defense Council for Approval of Settlement Agreement, May 21, 2009 in R.09-01-019 (Motion for Approval of Settlement Agreement) at 6. The Proposed Settlement is appended to the Motion for Approval of Settlement Agreement as Attachment A.

Parties filed pre-settlement position papers. The utilities' pre-settlement position is that utility self-reported energy efficiency savings should be relied upon for awarding a second interim payment. Based on self-reported results, PG&E claimed energy efficiency savings for the 2006-2008 cycle equal to 167% of Commission goals, yielding three-year RRIM earnings of \$244 million. Since 2006-2008 RRIM earnings for PG&E are capped at \$180 million, PG&E claimed incentive earnings of \$138 million. PG&E argues that 2006-2008 performance should be compared against the expectations for which the incentive mechanism was designed.

As a pre-settlement position, the Sempra utilities (SDG&E and SoCalGas) similarly oppose reliance on the Energy Division Verification Report for similar reasons as articulated by PG&E and SCE, arguing that the verification process adopted in D.07-09-043 is unlikely to produce a transparent, efficient, and timely basis to review 2006-2008 program activities by December 2009.

As a pre-settlement position, the Sempra utilities proposed that RRIM interim earnings be based on their 2008 Fourth Quarter Performance Reports, and applying the same methodology as was used to calculate the first interim award. The resulting 2006-2008 RRIM earnings, without considering holdbacks for each of the Sempra utilities are:

SDG&E	\$39,467,453
SoCalGas	<u>\$26,703,047</u>
Total	\$66,170,500

As a pre-settlement position, NRDC proposed that RRIM rewards or penalties be calculated on a uniform basis for all utilities. NRDC does not believe that incentives should be based on after-the-fact net-to-gross ratios.

The 2006-2008 total incentives claimed on a pre-settlement basis by the utilities sponsoring in the settlement, as compared with their settlement position (before adjustment for holdbacks), are as follows:

Proposed RRIM Earnings for 2006-2008

	<u>Pre-Settlement Utility Position</u>	<u>Settlement Position</u>
PG&E	\$244,074,497	\$181,693,684
SDG&E	\$ 39,467,453	\$ 33,089,113
SoCalGas	\$ 26,703,047	\$ 27,230,239

The settling parties propose interim awards for 2009 subject to a 35% holdback, and subject to the 2010 true-up, resulting in the following amounts:

Proposed 2009 & 2010 RRIM Payments Under the Settlement: (\$ in Thousands)

<u>IOU</u>	<u>Total 2006-08</u>	<u>06-07 Claim</u>	<u>Interim Claim Paid End of 2009</u>	<u>Carryover for 2010 True-up</u>
PG&E	\$180,000	\$41,500	\$ 76,600	\$
				61,899
SDG&E	28,667	10,800	14,853	13,813
SoCalGas	22,289	5,200	10,708	11,581

The Proposed Settlement starts with the utilities' pre-settlement positions, and makes modifications that they characterize as "necessary to avoid process breakdowns that occurred in the 2006-2007 interim claim process." The sponsors claim that the settlement allows for transparency, while avoiding the previous problems regarding delay and claimed lack of opportunity for formal vetting of the Draft Verification Report. The Settling Parties contend that in no event

should the second Verification Report be used to calculate 2009 interim payments.²⁸

Specifically, the Settlement (1) accepts certain 2008 DEER updates, exclusive of the specified categories discussed below; (2) applies the MPS to the goals achievement; (3) calculates the net energy savings, against which the MPS is applied; (4) calculates the net benefits, against which the PEB is derived; (5) adjusts for audits of costs and installations; (6) holds back 35% of the 2009 claim for the true-up process; and (7) applies the impact studies (with the exception of three areas) to the program savings in the true-up claim. The Settlement also proposes a schedule for a final true-up payment in 2010.

The Settling Parties claim that although they have not had a chance to fully vet the 2008 DEER updates, in the interests of settlement, they agree to accept certain 2008 DEER updates. The Settlement, however, would *reject* 2008 DEER updates for: (1) the net-to-gross ratio for measuring energy savings (except for certain net-to-gross adjustments made by SCE) and (2) estimated useful lives (EUL) of measures. Settling parties also propose that interactive effects included in the 2008 DEER update that were not considered in the original studies used to set 2006-2008 goals be excluded in computing the 2009 claim.

The Settlement applies different assumptions as compared with the Energy Division Verification Report for the upstream lighting program compact fluorescent lamps (CFL) usage allocated between residential and nonresidential customers, and for in-service rates for CFLs. The Settling Parties propose that

²⁸ Proposed Settlement, Paragraph 5(f) at S-5.

the 2009 claim be derived with no cost disallowances and a 1% reduction for items never installed.

Under the Proposed Settlement, a final incentive claim would be made in 2010 based on impact studies of 2006-2008 programs, to address the remaining 2006-2008 incentive claims previously held back. The Settlement contemplates a true-up of the CFL in-service rates and CFL split in the 2010 Verification Report, subject to the restrictions as explained below.

The Energy Division reviewed the mathematical accuracy of the settlement calculations, running the settlement figures through its "Verification Report Template," (VRT).²⁹ The VRT was developed to allow Energy Division to calculate the MPS and PEB in an efficient, transparent, and repeatable manner.

Energy Division also ran additional sensitivity calculations, changing certain assumptions underlying the Settlement figures. The results are summarized in a tabular series of scenario runs that modify the settlement figures, adjusted for the following modified assumptions:

- a. Excluding 2004-2005 goals and savings from the RRIM calculations;
- b. Incorporating Energy Division's verified installation rates; and
- c. Incorporating Energy Division's CFL in-service rates.

A summary showing the sensitivity of the RRIM earnings resulting from these scenario runs was set forth in the ALJ Ruling dated October 1, 2009.

3.2.2. Position of SCE on the Settlement

²⁹ The VRT is a Microsoft (MS) Access application used to compile IOU savings and cost claims and program tracking data. The VRT supports automated E3 Calculator runs and can summarize savings and net benefits by IOU, and place these results in the RRIM calculator developed by Energy Division.

SCE does not join in the Proposed Settlement, arguing that the Settlement extends an “already broken system” into 2010, and perpetuates the contentiousness that was brought before the Commission in the process surrounding the 2006-2007 Verification Report. SCE claims its self-reported performance results should be the basis for awarding remaining incentive earnings for 2006-2008.³⁰ SCE does not believe that there is any merit in holding back any of its claimed earnings for a 2010 true-up based on the claim that its showing fully supports a full award now. SCE’s affirmative proposal for incentive earnings is discussed in Sec. 3. 3.

3.2.3. Position of DRA, TURN, and WEM on Settlement

DRA, TURN, and WEM oppose the Settlement as well as the separate proposal of SCE. They argue that Proposed Settlement is not reasonable in light of the record, is inconsistent with the law, and is not in the public interest.³¹ TURN believes the settlement should be rejected for the same reasons as articulated in its application for rehearing of D.08-12-059. TURN alleges that the outcome reached in D.08-12-059 arbitrarily favored shareholders over ratepayers.³² TURN claims that the settlement “perpetuates an illegal give-away of ratepayer funds to the utilities.”

WEM also takes issue with the provision in the Proposed Settlement that places restrictions on the use of the Energy Division Verification Report true-up due by March 2010.

³⁰ The substance of SCE’s incentive claim for 2006-2008 is covered in Sec. 3.4 below.

³¹ Rule 12 of the Commission’s Rules of Practice and Procedure.

³² TURN attached for reference the DRA and TURN joint “Application for Rehearing of Decision 08-12-059” as Attachment A to this pleading.

DRA argues that incentives should be paid only for independently verified savings that approach or exceed the goals in D.04-09-060 based on the most recent parameters. DRA opposes further incentive payments for the 2006-2008 cycle unless the Verification Report or ex post evaluations show that energy efficiency programs reached at least 80% of MPS for SoCalGas or 85% for the electric IOUs, as established in D.07-09-043.

DRA opposes the Settlement for failing to incorporate the final impact studies for the net-to-gross ratio, EULs and interactive effects in calculating the final incentive payments measurements (subject to the limitations enacted in D.08-01-042). DRA argues that the Settlement contravenes D.05-01-055's policy regarding independent EM&V. D.05-01-055 recognized that an "entity other than the one standing to profit from inflated program achievements should be responsible for substantiating program performance."³³ DRA argues that the Proposed Settlement would disregard the impact studies relating to the net-to-gross ratio, EULs and interactive effects, thereby undermining this policy. DRA argues that all the results of the Energy Division impact studies should be incorporated after parties have the opportunity to comment on them.

DRA claims that the proposed settlement selects those aspects of EM&V studies that produce favorable investor earnings results. If the Commission wishes to simplify the 2009 claims process along the lines suggested by the Proposed Settlement, DRA argues that the holdback be increased from 35% to 80%. Emphasizing this aspect of the protections implemented in D.08-01-042 would compensate for failure to use the most up-to-date parameters as directed

³³ D.05-01-055 at 121.

by that decision. DRA argues that the results of the ongoing impact studies should not be ignored in calculating the utilities' 2010 final payment claims.

TURN argues that favoring "timely" profits over "real" savings violates past Commission decisions and the purported goals of an incentive mechanism. TURN believes that the Settlement goes beyond "streamlining" by eliminating updates of basic engineering parameters that determine the actual gross savings from energy efficiency measures. TURN questions how the utilities and NRDC can claim that studies supporting DEER updates are "outdated," when these parties would prefer to rely on 2005 DEER data that are sometimes based on studies from the mid-90's.

3.3. Proposal of SCE for RRIM Awards

Based on its self-reported results, SCE claims entitlement to \$154,856,488 in incentive earnings as final compensation for the 2006-2008 cycle, to be authorized in full by the end of 2009. SCE presents the following supporting calculations underlying its incentive claim:

Savings Metric	Savings Metric 2006-08 CPUC Goal	Savings Metric 2006-08 SCE Results
Energy Savings (GWh)	3,135,000,000	4,119,626,221
Demand Reduction(MW)	672,000	745,963

Earnings Tier Achieved	Tier II (12%)	
<u>Performance Earnings Basis (PEB)</u>		
Total Resource Cost (TRC) Net Benefits	\$	1,159,501,850
Program Administrator Cost (PAC) Net Benefits	\$	1,552,408,491
PEB	\$	1,290,470,730
<u>Shareholder Earnings</u>		
2006-08 Total Earnings Claim	\$	154,856,488

SCE characterizes its showing as unique in that its energy savings estimates were adjusted and updated over the course of the 2006-2008 program cycle based on a thorough review and evaluation of newly released information sources, such as the Commission's final measurement evaluation of the 2004-2005 energy efficiency programs. Absent these adjustments, SCE calculated that incentive earnings would be \$164 million. SCE asserts that its actual claim of \$154.9 million entails minimal risk of overpayment by ratepayers. SCE claims that its installations have been independently verified, and argues that its proposal offers the finality needed to resolve all aspects of the 2006-2008 program cycle by the end of 2009.

The results reported by SCE for the 2006-2008 program cycle incorporated actual equipment installations based on a combination of Commission-approved DEER 2005 estimates, SCE work papers, and recent measurement studies, and were submitted to the Commission on March 2, 2009. SCE states that it made updates to its portfolio based on the recommendations of approved and properly vetted measurement studies that SCE asserts complied with Commission-approved EM&V protocols. These studies included the final impact evaluations of the 2004-2005 energy efficiency programs that were released throughout the 2006-2008 program cycle. When a study was released, it was evaluated by SCE's measurement and engineering staff. SCE conducted an analysis to determine if the measurement study created an appropriate comparison to SCE's current energy efficiency programs and the market conditions in which the program was currently operating. If a study met those qualifications, the results of the study were further evaluated with respect to sample size and design, and the basis of its conclusions. When SCE believed that the conclusions were reasonable and credible, it integrated them into SCE work papers. Where SCE determines that

the conclusions were not reasonable or were otherwise not appropriate for its current portfolio of programs, they were not utilized in adjusting energy savings estimated. Where SCE did not use the results of certain studies, SCE explained the reasons in its work papers. SCE states that it adopted recommendations of studies that produced both negative and positive results.

DRA opposes the SCE proposed incentive earnings claims, arguing that the only support offered by SCE is a single statistical table and a website reference.³⁴ DRA argues that because SCE fails to provide a calculation of the PEB, it is impossible to determine compliance with the Commission's adopted treatment of program costs and energy savings. Based on a rough calculation of PEB, DRA claims that the SCE incentive earnings appear to be one-half million too high, thus demonstrating the need for independent verification of the PEB calculation. SCE's Report includes two sets of E3 calculator export files, but there is no indication as to which were used, or should be used, to assess performance. The SCE Report also includes no portfolio level description of whether Commission-adopted energy savings counting rules were followed.

DRA argues that SCE's proposal ignores the long-standing Commission policy of using ex post evaluation as the ultimate measure of energy efficiency program performance. DRA states that in the updated policy rules for energy efficiency programs adopted in April 2005, the Commission specifically supported DRA's proposal that, as a general policy, ex post reevaluation of per-unit energy savings through load impact studies should be required to

³⁴ SCE Testimony at 10, and Attachment A.

adjust the performance basis for prior program years.³⁵ While the Commission carved out an exception to the general policy for well-established ex ante values “with a high degree of confidence, and low external sources of variability,” this exception referred to measures expected to perform as estimated once installed, and therefore which did not require ex post load evaluations to be tied to compensation.³⁶ DRA argues that in creating this exception for only well-established ex ante values, the Commission did not contemplate measures such as interactive effects, expected useful lives, net-to-gross ratios, whose values are subject to considerable debate and controversy. DRA thus contends that SCE has no basis for eliminating the ex post true-up process from its shareholder incentive mechanisms claims, when the Commission has repeatedly directed that energy savings be verified by ex post true-up, specifically with regard to net-to-gross ratios.

3.4. Discussion

3.4.1. Merits of the Proposed Settlement

We first consider whether the Proposed Settlement merits adoption. Under Rule 12.1(d) of the Commission’s Rules of Practice and Procedure, we will not approve settlements, whether contested or uncontested, unless the settlement is reasonable in light of the whole record, consistent with the law, and in the public interest. In reviewing a settlement, we consider individual provisions but do not necessarily base our conclusion on whether an isolated provision of the Settlement is, in and of itself, an optimal outcome. Instead, we consider whether

³⁵ D.05-04-051 at 50-51

³⁶ *Id.* at 52.

the settlement, as a whole, is in the public interest. Since the proposed settlement here is not an all-party settlement, we also weigh relevant objections or concerns of opposing parties. Moreover, in a rulemaking such as this, our responsibility is to resolve policy issues that affect the public interest. In considering the merits of the settlement, therefore, we must assess whether the settlement serves the broad public interests at issue in this rulemaking.

In reviewing this settlement, we look to relevant precedents relating to contested settlements affecting a broad public interest. In D.88-12-083,³⁷ for example, we approved a settlement that resolved claims that costs incurred by PG&E to design and construct the Diablo Canyon nuclear power plan should be disallowed from recovery through rates.

In evaluating a settlement affecting all PG&E customers, such as the Diablo Canyon settlement, the Commission stated that the factors used by the courts in approving class action settlements provided appropriate criteria. The Commission stated:

The standard used by the courts in their review of proposed settlements is whether the class action settlement is fundamentally fair, adequate, and reasonable. [Citations omitted.] The burden of proving that the settlement is fair is on the proponents of the settlement. [Citations omitted.]

In order to determine whether the settlement is fair, adequate, and reasonable, the court will balance various factors which may include . . . : the strength of applicant's case; the risk, expense, complexity, and likely duration of further litigation; the amount offered in settlement; the extent to which discovery has been completed so that the opposing parties can

³⁷ *Re Pacific Gas and Electric Company* (1988) D.88-12-083, 30 CPUC2d 189, 222.

gauge the strength and weakness of all parties; the stage of the proceedings; the experience and views of counsel; the presence of a governmental participant; and the reaction of class members to the proposed settlement. [Citations omitted.] In addition, other factors to consider are whether the settlement negotiations were at arm's length and without collusion; whether the major issues are addressed in the settlement; whether segments of the class are treated differently in the settlement; and the adequacy of representation. [Citations omitted.] (*Diablo Canyon*, 30 CPUC2d, 189, 222.)

We consider these principles in evaluating the Settlement before us. We are guided first and foremost by our responsibility to promote the public interest, and will only approve the settlement if -- or to the extent that -- it assists in carrying out our responsibility in a manner that serves the public interest. Since the proposed settlement is contested, we also evaluate it in light of opposing positions for determining the second interim RRIM payment, including those which would rely upon the Energy Division Verification Report.

While we encouraged parties to seek settlement as a potential alternative to protracted disputes over the extensive technical details of the huge body of data underlying the incentive earnings calculations, we do not find the outcome of the settlement process produced a useful solution. We conclude that the Proposed Settlement is not reasonable in light of the whole record as a basis for authorizing incentive awards, and is not in the public interest. The utilities' pre-settlement position is weak to the extent it relies upon utility self-reported earnings without independent verification. Thus, we find little value in the Settlement in terms of any concessions giving up those unsubstantiated claims in exchange of the Settlement terms. The Settlement lacks the sponsorship of

parties representing ratepayer advocates (i.e., DRA, TURN, and WEM). As such, the sponsors do not represent all affected interests.

The Settlement seeks to justify excluding various DEER updates, characterizing them as “those aspects of the [incentive claim] process that failed to work as intended.” This reference is to the controversies surrounding the Energy Division Verification Report and resulting delays in resolving incentive claims during 2008. The Settlement’s presumed solution, however, introduces its own separate difficulties that fail to offer a fair outcome.

The Proposed Settlement would partially reverse the D.08-01-042 requirement to update *ex ante* assumptions used to assess RRIM claims. The Settlement would thereby eliminate the balance achieved in D.08-01-042, by removing essential protections against ratepayers’ risk of overpayment of incentives. In denying the IOUs’ previous request to retreat from our directive to require 2008 DEER updating in D.08-12-049, we stated:

At this point we do not think it would be reasonable to remove, in part or in whole, the requirement that the *ex ante* assumptions used to assess interim claims be updated. This updating is part and parcel of the balance that was struck in D.08-01-042 between providing utilities the ability to book interim rewards without the uncertainty that they would have to return these interim amounts after the fact, and limiting the risk to ratepayers of overpayment.

By not updating key *ex ante* assumptions, the Settlement fails to produce a reasonable basis for measuring incentives, but increases the risk of overpayment of interim incentives. The process was consistent with D.08-01-042 which stated:

Updating measure load impacts using the DEER database prior to the payout of interim claims in 2008 and 2009 should help to mitigate the risk of extremely large swings in earnings (positive or negative) at the final earnings true-up, which

serves the interests of both utility shareholders and ratepayers.³⁸

In view of our adopted policy not to require the utilities to refund overpayment of incentives, it is particularly important to avoid awarding interim payments based on outdated ex ante load impact assumptions.

One of the key principles underlying the RRIM as adopted in D.07-09-043 was that all calculations of net benefits and energy savings achievements were to be independently verified by the Commission's Energy Division and its EM&V contractors, based on adopted EM&V protocols. Yet the proposals of both the settling parties and SCE disregard the Verification Report process which is the vehicle through which such independent verification is accomplished.

Sponsoring parties claim that almost all of the energy savings in the settlement would be adjusted using the Energy Division's 2008 DEER assumptions except for the five proposed adjustments, making the 2009 claim much closer to what the Commission expected applying existing processes. Sponsoring parties thus argue that the risk of overpayment is not significantly different from the risk envisioned in D.08-01-042, with a 35% holdback.

Although the Settlement accepts the 2008 DEER updates for many individual measures, the resulting net dollar impact may have little or no impact on the overall RRIM earnings claimed by the utilities. While the settling parties identify only five categories of assumptions excluded from the 2008 DEER update, those categories involve a significantly large dollar amount of each utility's total portfolio savings. The percentage impacts on total dollar RRIM earnings resulting from excluding these five categories in the 2008 DEER update

³⁸ D.08-01-042 at 17.

are disproportionately high in relation to the total number of measures subject to the calculation. These proposed DEER exceptions constitute significant revisions to the methodology underlying D.08-01-042 which limited the final true-up of interim payments to the utilities for energy savings, but directed that calculation of the interim claim incorporate updated 2008 savings parameters to limit the risk of over payment.

The relative magnitude of the effects of excluding the five categories of savings parameters can be observed by comparing the incentive earnings calculated in the Verification Report versus the Settlement. The magnitude of differences between these sources significantly exceeds the 35% holdback.

We disagree with Sponsoring Parties' claim that ratepayers' risk of overpayment under the Proposed Settlement is not significantly different than what was assumed in D.08-01-042. We concluded in that decision that ratepayers would be reasonably protected from overpayment based on the premise that the interim incentive payment would be based upon an updated 2008 DEER. Although we subsequently utilized self-reported utility claims as the basis for 2006-2007 interim RRIM payments in D.08-12-059, we did so only because the First Verification Report was not available in time. We also increased the holdback to 65%, reflecting increased uncertainties associated with self-reported claims. Moreover, as a threshold for considering a second interim RRIM payment for each utility, D.08-12-059 stated:

For the second interim claim (covering 2008 program performance), should Energy Division's verification reports be delayed such that any interim claims that may be owed cannot be authorized in 2009 pursuant to the schedule established in D.07-09-043, interim claims will be based on the IOUs' submitted quarterly savings reports subject to a holdback amount of *at least 65% with the specific holdback*

amount determined at the discretion of the assigned Commissioner based on the risk of overpayment. (D.08-12-059 at 3.) (Emphasis added.)

The hypothetical RRIM payment under this scenario would set as a minimum starting point for considering a holdback amount the following figures (in \$ millions) based on 65% applied to IOU self-reported RRIM claims:

	<u>PG&E</u>	<u>SCE</u>	<u>SDG&E</u>	<u>SoCalGas</u>
Self-Reported Claim	\$244.1	\$154.8	\$39.5	\$26.7
Less 65% Hold-Back	(158.6)	(100.6)	(25.6)	(17.3)
Hypothetical 2 nd Payment	<u>85.4</u>	<u>54.2</u>	<u>13.9</u>	<u>9.3</u>

The interim payments under this hypothetical holdback exceed the amounts that PG&E and SDG&E claim in the Settlement, but are less than the amounts SCE and SoCalGas claim, and still significantly exceed the RRIM earnings calculated in the Verification Report.

DRA proposes that if the settlement figures were to be used as a basis for incentive payments, then 80% of the interim claim amount should be held back (rather than 35%) to mitigate additional risk of overpayment. Sponsoring parties argue that the 80% holdback proposal is excessive and based on a misplaced belief that the 2009 interim claim does not adequately reflect the 2008 DEER assumptions, and therefore that ratepayers are at significant risk of overpaying incentive claims.

In the event that the incentive payment is subsequently found to be overstated, the ratepayer-versus-shareholder risk is asymmetrical. As long as an overstatement is within the deadband zone, the utility is not required to repay any RRIM earnings. If the interim incentive amount is found to be understated, however, the utility will still be made whole for any shortfall in the true-up. Utility investor risk is limited to the possible lost time value of money associated

with a one-year delay in any additional RRIM earnings. Thus, the utility investor's risk of loss is modest in comparison to the upside opportunity for additional incentive earnings in the true-up.

On the other hand, the ratepayer will *not* receive a refund of the overpayments in incentives unless the amount is large enough to place the utility into the penalty zone. Yet, if the interim RRIM payment is found to be understated, the ratepayer *will pay* any shortfall in the subsequent true-up. Accordingly, because of additional risks to the ratepayer, it is important to set the interim awards at a level sufficient to protect against overpayment by ratepayers. The interim awards in the Proposed Settlement fail to provide the requisite protection, particularly in view of risks that the settlement may ultimately result in a lower ex post earnings.

We consider below each of the categories of assumptions that the Settlement would decline to update.

3.4.1.1. Adjustments to Net-to-Gross Ratios

In the context of energy efficiency programs, the net-to-gross ratio measures “free riders,” i.e, the portion of participants who would have undertaken an energy efficiency activity even absent a utility program.³⁹ In D.07-09-043, we designed the RRIM to limit incentive awards only to those savings that directly result from utility programs, thus excluding “free riders.” Applying the net-to-gross adjustment to program savings, in turn, motivates the utilities to direct energy efficiency dollars to achieve results that would not otherwise have occurred as a factor in determining what energy efficiency programs to pursue.

The Settlement proposes to exclude updated 2008 DEER adjustments in net-to-gross ratios for purposes of computing RRIM earnings both for the second interim installment as well as for the final 2010 true-up. Instead, the Settlement would simply apply the adopted 2005 DEER values for net-to-gross that served as the basis for the 2006-2008 applications (except that the adjustments made by SCE for net-to-gross will be recognized).

There are two separate disputes at issue regarding the net-to-gross ratio: (1) whether the net-to-gross ratio should be updated at all during the 2006-2008 cycle, and (2) if so, what updated figure should apply. We conclude that the Proposed Settlement has not justified relying on outdated 2005 DEER net-to-gross assumptions for purposes of the interim incentive payment. When we called for the updating of DEER parameters in D.08-01-042, we did not exclude the net-to-gross ratio from that requirement. Likewise, there is no basis

³⁹ For example, a net-to-gross ratio of 0.80 indicates that 80% of total participants are not free riders.

to disregard net-to-gross effects in making the 2010 update. None of the arguments presented by the Settling Parties justify their proposal not to update the net-to-gross ratio.

The Settling Parties acknowledge that the net-to-gross adjustment is an important parameter for ensuring effective programs that deliver incremental savings, and for determining what energy efficiency programs to pursue. The Settling Parties agree that net-to-gross ratios should continue to be evaluated and measured, with new results incorporated into the utilities' portfolio planning for upcoming cycles as they become available. Settling Parties, however, claim that an update or a true-up of the net-to-gross ratios for purposes of calculating RRIM payments would constitute a "retroactive" adjustment that is inconsistent with Commission policy and not appropriate for assessment of utility performance. They argue that the net-to-gross ratio should not be updated or trued up for the purposes of assessing the utilities' performance under the RRIM for 2006-2008. They argue that net-to-gross reassessments are asymmetrical, as they neglect positive spillover impacts both inside and outside the participant group (such as those associated with efficiency standards that the programs facilitate).⁴⁰ They argue that the current three-year program cycle is not able to provide useful and timely mid-cycle feedback to the utilities.

Even though the Settling Parties do not believe net-to-gross ratios should be trued-up for computing incentive awards, they do propose that the utilities incorporate net-to-gross updates based on fully vetted 2004-2005 EM&V studies

⁴⁰ Although the Commission in D.07-10-032 has directed staff to examine and explore both participant and non-participant spillover effects, these effects have not been quantified or counted toward the utilities' 2006-2008 savings.

to ensure the most current net-to-gross values are used in determining program accomplishments.⁴¹ These are consistent with the adjustments made by SCE during the 2006-2008 program cycle. The IOUs claim that recent net-to-gross updating studies have not been properly vetted, have erroneous assumptions, and exclude positive spillover market effects.

TURN acknowledges that the net-to-gross ratios have caused particular controversy both because the evaluation methods depend on customer behavior survey results and because positive impacts in market transformation – for example, greater consumer awareness of the benefits of CFLs – will reduce utility savings.⁴² The controversy over key parameters, most notably net-to-gross ratios, was discussed at length in D.05-09-043, which authorized 2006-2908 programs. The decision cautioned that “[s]pecific sensitivities around the net-to-gross ratio assumptions contained in the PG&E and SCE PRG reports, as well as in TURN’s opening comments, indicate that the proposed portfolios may not meet the cumulative 2006-2008 energy (GWh) savings targets.”⁴³ The Commission found “some risk that the portfolio plans may not meet the Commission-adopted GWh and therm energy savings goals, due to uncertainties

⁴¹ Program areas where net-to-gross updates were applied include Appliance Recycling, Residential Lighting, Multi-Family Energy Efficiency, Heating Ventilation and Air Conditioning measures, Industrial Energy Efficiency, Agricultural Energy Efficiency, Savings-By-Design, and Express Efficiency measures.

⁴² The net-to-gross for CFLs is one of the key parameters that has changed, as consumer demand for CFLs has increased due to the combined impacts of utility rebate programs, supply growth and price declines from large retailers such as WalMart, and greater public awareness of the impact of climate change and its relation to electricity production.

⁴³ D.05-09-043, *mimeo.* at 56. See, generally, the discussion concerning the Case Management Statement at 53-56.

over free ridership assumptions and the useful life estimates associated with certain lighting measures, among others.”⁴⁴ The Commission stated that net-to-gross ratios used for planning purposes would be “further addressed through ex post true-up of these ratios in performance basis evaluation, consistent with our direction in D.05-04-051.”⁴⁵

SCE claims that the Verification Report is faulty in its determination that a net-to-gross ratio of 60% is valid for CFLs delivered through upstream channels. SCE argues that because the Verification Report figure is based upon anticipated national sales trends associated with CFL purchases, the resulting figure is not from a Commission-approved measurement study. SCE argues that its net-to-gross figure of 75% is more defensible since it is based on the same study used its 2004-2005 impact evaluation, and the same figure continues to guide the 2009 upstream lighting program.

We acknowledge that energy efficiency benefits to the economy and environment reflect gross savings from utility programs, not recalculated net savings absent free riders. Nonetheless, the goal of the RRIM is to measure program results within utility control, including portfolio mix and program design. The Commission recognized that “[o]ur fund shifting rules provide the utilities with a great deal of latitude to manage their authorized funding levels over the three-year program cycle, in order to maximize the performance of their portfolios with respect to savings accomplishments and cost-effectiveness.”⁴⁶ The measure of utility control is gauged through the net-to-gross ratio.

⁴⁴ D.05-09-043, *mimeo.* at 166, Finding of Fact No. 4.

⁴⁵ *Id.*, at 167, Finding of Fact No. 7.

⁴⁶ D.07-11-004 at 8.

Calculating incentives with meaningful net-to-gross ratios encourages the utilities to pursue savings that would otherwise be unattainable in the absence of their energy efficiency programs.

Preliminary EM&V results from 2004-2005 programs showed lower net-to-gross ratios than anticipated,⁴⁷ with the result that less energy was saved as a result of their programs, and programs were less cost effective.⁴⁸

We recognize that studies that evaluate and measure net-to-gross ratios are inherently difficult. These studies that evaluate net-to-gross ratios ask customers deploying energy efficiency measures to recall whether their decision to adopt such measures, sometimes more than a year before, was directly attributable to utility programs. The fact that net-to-gross ratios are difficult to measure does not mean that we should ignore net-to-gross effects in calculating incentive awards. The importance of net-to-gross in relation to incentives for performance should not be minimized merely because net-to-gross measurement is not an exact science and is difficult to measure. If the Utilities earn incentives on energy savings that would have occurred even without their programs, the incentive mechanism loses its effectiveness as a tool to achieve energy efficiency goals, and to reduce greenhouse gas emissions.

Settling parties argue that requiring ex post true-up of net-to-gross ratios could skew program designs by unduly emphasizing the utilities performance instead of broader goals of energy efficiency irrespective of utility attribution.

47 Although the First PFM implies that the lower EM&V results came as a surprise, the Office of Ratepayer Advocates and TURN, and a report by consultant TecMarket Works, criticized the net-to-gross values used by the Utilities in planning their 2006-2008 portfolios as unrealistically high. D.05-09-043 at 54-55.

48 See e.g., PG&E August 29, 2007 Comments on PD in R.06-04-010, at 4-5.

We conclude that the alternative is less desirable, namely requiring ratepayers to fund incentive payments for energy efficiency results that would have occurred even without utility efforts.

We disagree with the Settling Parties' characterization of a true-up of the net-to-gross ratio as being "retroactive" and as inconsistent with Commission policy. The true-up is not "retroactive" in the sense of updating a factor that was originally never intended to be updated during the program cycle. On the contrary, the Utilities have been on notice since at least September 2005 that *ex post* net-to-gross ratios would be used to true-up energy efficiency savings.⁴⁹ As stated in D.05-09-043, p. 96:

Our decision today on how best to bound the uncertainty associated with this key savings parameter for planning purposes is predicated on the expectation that net-to-gross *will* in fact be adjusted (trued-up) on an *ex post* basis when we evaluate actual portfolio performance. We believe that this is entirely consistent with the resolution of threshold EM&V issues in D.05-04-051.

While the net-to-gross number does not impact the amount of gross savings from all energy efficiency investments, the savings attribution *does* impact the cost-effectiveness calculations, and the basis for *allocating* the gross savings between the utility and other impacts. In summary, we incorporate the

⁴⁹ See Assigned Commissioner's Ruling [in R.06-04-010] Addressing Net-To-Gross Ratio True-Up and Methodology for Lighting Programs in the 2006-2008 Energy Efficiency Portfolios, filed October 5, 2007 at 2; September 2, 2005 Administrative Law Judge Ruling [in R.01-08-028] on EM&V Protocol Issues, Appendix 3 (Net-To-Gross would be trued-up with a final report at the end of the program cycle.)

2008 DEER update of net-to-gross ratios in computing authorized RRIM earnings.

3.4.1.2. Exclusion of Effective Useful Life Estimates

The effective useful life (EUL) is an “estimate of the median number of years that the measures installed under the program are still in place and operable.”⁵⁰ The Proposed Settlement would exclude the EUL from the 2008 DEER update of energy savings measures, but instead use the 2005 ex ante EUL values for calculating RRIM earnings for 2006-2008 performance. The Settling Parties propose not to update the EUL either for the interim or for the final true-up payment.

Settling Parties believe that efficiency program administrators cannot be reasonably expected to control EUL values and to update and adjust portfolios within a single program cycle from the results of persistence studies. Settling parties agree that persistence studies are important for program planning over longer horizons, but oppose using the 2008 ex ante EUL assumptions for the 2006-2008 program cycle. Settling Parties claim that accurately tracking persistence of measures installed within a three-year program cycle (which often persist for many years), completing and vetting studies in time for mid-cycle adjustments, and timely incentive assessments are impossible.

SCE also objects to the EUL values in the Verification Report, arguing that the revised values are based on “highly complex, yet unstable engineering calculations, based on statistically invalid samples and market conditions.” SCE claims that the DEER update ignores a retention study of 1994 CFLs

⁵⁰ The California Evaluation Framework, TecMarket Works, June 2004 at 418.

conducted according to Commission-adopted EM&V protocols. SCE claims that when that study is updated with the characteristics of modern CFL technology, the results support an EUL of 9.4 years, the same as currently utilized by the IOUs and as contained in the 2005 DEER.

DRA believes that the EUL is an important parameter for accurately estimating energy savings achieved by energy efficiency programs. D.08-01-042 directed the Energy Division to update DEER parameters, including EULs, as part of a package that limited true-up of the Utilities' interim claims, and directed the use of updated DEER information in calculating those claims.

DRA argues that although the Proposed Settlement seeks a reversal of course on EULs, it fails to justify disregarding the most accurate information for estimating EULs.

We conclude that the rationale offered by the settlement to justify no updates to EUL values is not persuasive. D.08-01-042 mandated updates to DEER parameters, including EULs, as part of a package to limit the risk of overpayment of utilities' interim claims. The Energy Division Verification Report thus incorporated updates to EULs, accepted comments from parties and made adjustments as appropriate. Prior to the DEER update, the EUL for residential indoor CFLs failed to reflect usage patterns associated with those CFLs and led to shorter lamp life than the rated life.⁵¹ After considering available studies and other evidence, the Energy Division adjusted the EUL for indoor residential CFLs downward to reflect usage patterns associated with indoor residential CFLs.

⁵¹ See October 10, 2008 Energy Division EUL Comments and Response to posted at <http://www.energydataweb.com/cpuc/> at 2.

The settlement contravenes D.08-01-042. Accordingly, we rely upon the DEER updates for the EUL as reflected in the Verification Report.

3.4.1.3. CFL In-Service Rate Update

The Settlement recommends that the in-service CFL rates be updated, but not until the Energy Division has completed its study on CFL in-service rates and parties have the opportunity to fully vet the study. The Settling Parties submit that it is reasonable to update the CFL in-service rate only in the final claim in 2010.

The Sempra utilities argue that 2008 DEER updated value of 0.67 for CFL installation/in-service rate value is based solely on a telephone interview and not a completed measurement study which would include on-site verification. They argue that this reduction of almost 15% from the existing ex ante value has a very significant impact on one of SDG&E's largest programs. The study also did not consider any deferred installation of CFLs and essentially assumes all bulbs not installed will be destroyed. Sempra argues that the original ex ante values should be restored in the final verification report.

We disagree with Settling Parties that the updating of the CFL in-service rates should be postponed to the final true-up. Postponement would place ratepayers at greater risk of paying interim incentives that are overstated. On the other hand, incorporating the Verification Report's updated CFL values into the interim incentive payment now will not prevent the utility investor from being made whole next year, assuming that there is a further change in the assumed CFL in-service rate in the 2010 true-up that increases the applicable incentive amount.

3.4.1.4. CFL Usage Split Between Residential and Commercial

For purposes of calculating interim claims, the Proposed Settlement excludes Energy Division Verification Report's calculations as to the proportion of CFLs attributed to residential versus nonresidential customers for the upstream lighting program. The Energy Division applies a 95/5 split for CFLs, while the Proposed Settlement would use a 90/10 split.⁵² Attribution of more CFLs to nonresidential customers assumes more peak energy savings, and produces a calculation of greater annual energy savings. The Settling Parties argue that the 90/10 assumption is more appropriate because it "is based on a final, vetted study" while the 95/5 assumption was not "based on reviewed and fully vetted report."⁵³

SCE assumes that 90% of the upstream CFLs are installed in residential buildings and 10% are installed in nonresidential buildings, citing an analysis of 1994 consumer mail-in survey data (manufacturer bounce back cards). PG&E uses the same 90%/10% installation split, but did not provide a workpaper to Energy Division to support this assumption. SDG&E, which implements essentially the same upstream lighting program, assumes that 100% of the upstream CFLs are installed in residential buildings.

⁵² See October 10, 2008 Energy Division EUL Comments and Response to posted at <http://www.energydataweb.com/cpuc/> at 2.

⁵³ When SDG&E filed its portfolio, it attributed 100% of its upstream lighting program CFLs to residential customers. Energy Division changed SDG&E's attribution of CFLs from 100/0 to 95/5 in response to more recent saturation and sales data indicating that was a more accurate estimate of the CFL split between residential and nonresidential customers.

We can not validate the claim of 90%/10% installation split assumption for upstream CFLs sold, for the following reasons as stated in the Verification Report:⁵⁴

- A. There are likely to be significant differences between the 1994 programs, lighting products, and purchasing patterns compared to 2006-2008.
- B. The extent to which the 1994 consumer mail-in survey data contains possible self-selection bias is not known.
- C. Whether or not the 1994 consumer mail-in survey data were drawn from a random and representative sample of customers cannot be ascertained.
- D. Customer survey data collected between 2004 and 2007 as part of the upstream lighting program evaluations suggest that the proportion of commercial customer purchases is likely to be between 3% and 7%.
- E. Preliminary data from 2006-2007 in-store intercept surveys suggest that the volume of CFL purchased by nonresidential customers from retail channels is about 2%, but the data do not appear representative and conclusive at this time.
- F. Surveys of recipients of CFLs given away at the events organized by IOUs in 2006-2007 show that 1-2% of CFLs given away are installed in nonresidential premises.⁵⁵
- G. The number of commercial building sockets which can receive CFLs (data available from the Commercial End Use Survey database) combined with the fraction of likely upstream commercial purchasers (in D above) does not appear to support more than 2-5% of the 2006-2007 upstream CFLs

⁵⁴ See Second Verification Report at 72-73.

⁵⁵ See Appendix A5.

volume (>50,000,000 bulbs) being installed in non-residential buildings.

According to the Verification Report, the relevant data sources strongly suggest that nonresidential installations of CFLs sold through upstream programs are less than 10%. The Verification Report therefore applied a 5% rate of upstream CFL products --rather than 10%-- as the percentage installed in nonresidential buildings (or that 100% of upstream CFL products are installed in residential buildings as SDG&E assumed).

We rely upon the Verification Report's assumed split between residential and commercial CFL usage rather than the study supporting the 90/10 split which is based was a 1994 mail-in survey of customers. We conclude that the 90/10 split assumed by utilities has not been justified given: (1) the potentially significant differences between programs, lighting products and purchasing patterns in 1994 as compared to 2006-2007; and (2) more recent customer survey data from 2006-2007 indicating that the percentage of nonresidential CFL purchases is likely to be between 3% and 7%; and information about the number of commercial sockets available for CFL installation.⁵⁶ The more recent information reviewed by Energy Division regarding the likely distribution of CFLs between the residential and nonresidential sector is more reliable than a 15-year-old study that supports a 90/10 assumption.

3.5. Merits of SCE's Proposal

We similarly conclude that SCE has not justified an award of \$154 million based upon its own self-reported performance without independent third-party

⁵⁶ CPUC Energy Efficiency 2006-2007 Final Verification Report at 58-59.

verification. While SCE objects to reliance on the Energy Division Verification Report based on claims that it has not been vetted and is a “black box,” SCE fails to demonstrate that its own self-reported earnings claims have been subject to a greater degree of vetting or that they are more transparent. Granting an RRIM award based on SCE’s self-reported earnings would violate the Commission’s requirement that RRIM earnings must be based upon independently verified results.

We also disagree with SCE’s proposal for final payment of 100% of its remaining 2006-2008 incentive claims by year-end 2009. Although SCE’s proposal would theoretically eliminate controversy next year over ex post calculations, it would do so by disregarding the risks involved in unfairly placing ratepayers at risk for overpayment of the incentives. In making its recommendation, SCE would eliminate the protections that were put in place previously to guard against ratepayers’ overpayment of incentives by holding back a percentage of the total interim claim. By limiting any SCE incentive payment based on the results of the Verification Report, and with an appropriate holdback allowance, we provide necessary protection against the potential for ratepayers to pay excessive amounts for incentives that exceed any actual benefits realized.

4. Adopted Amounts for the Second Installment of Interim Incentive Earnings

We conclude that the Energy Division’s Second Verification Report provides the appropriate basis for setting the second installment of interim incentive claims. The Commission officially adopted the Energy Division Verification Report by Resolution E-4272 on October 15, 2009. The Commission previously recognized the importance of independent verification in ensuring

that ratepayers get value commensurate with their energy efficiency investment, that programs are well designed, and that energy efficiency is considered a reliable resource comparable to supply side resources.⁵⁷ The Energy Division Second Verification Report is the only source in the record that offers an independent assessment of earnings from a neutral perspective.

We find the utilities' reasons for ignoring the second Verification Report in considering interim incentives to be unpersuasive. The utilities' characterization of the delay in the first Verification Report as a "process breakdown" was a one-time event. The one-time delay in issuing the earlier report was due to the Commission mandate for Energy Division to update DEER assumptions in the middle of the three-year program cycle. As a condition for allowing the utilities to retain incentive earnings awarded during the interim cycles, therefore, we required more timely DEER updates as the basis for those earnings, including net-to-gross ratios and expected useful lives. (D.08-01-042 at 16.) We based the first incentive payment on utility self-reported performance (with a 65% holdback to protect ratepayers) only because the Energy Division Verification Report was not available in time.

We face different circumstances now as we consider the second interim claim. Unlike the situation last year, the Second Verification Report has been completed in time to assess utility performance and the resulting second interim RRIM awards that are now due. A one-time event that precluded reliance on the first Verification Report does not justify ignoring the second Verification Report in determining the second interim award.

⁵⁷ D.05-01-055 at 112.

The remaining dispute is based on claims that the Verification Report and its underlying assumptions are filled with errors, were not properly vetted and not transparent.

SCE claims that the Energy Division Verification Reports were to be a “simple calculation of the number of measure installations and portfolio and program costs.” (SCE Testimony at 20.) In making this characterization, however, SCE does not take into account the D.08-01-042 mandate for DEER updating, or the complexities inherent in the updating of the DEER, a task that involves much more than “simple calculations.” The use of updated DEER values to reduce the risk of overpayment of incentives has continued to engender controversy among the parties, as evident from comments filed on the most recent Verification Report.

Parties provided written comments in response to the draft resolution to adopt the second interim Verification Report. The utilities generally take the position that second Verification Report uses the same methodologies as used to produce the results in the first Verification Report. PG&E claims that many of the errors that it identified in its comments on the first Verification Report have not been corrected or acted upon in the second report. PG&E argues that the second Verification Report failed to sufficiently explain the rationale for simply discarding criticisms in parties’ written comments. The Sempra utilities express a similar view, taking issue with the 2008 DEER updates.

While we appreciate that the second Verification Report necessarily involves considerable technical complexity and detail, we find that Energy Division adhered to Commission-adopted process protocols for stakeholder

input and vetting.⁵⁸ Energy Division circulated requests for technical participation from parties, provided draft materials, held several meetings to discuss technical issues, provided opportunities for comments, and responded to those comments in writing. Energy Division posted draft DEER values for stakeholders to review and provide written comments as to how applicable ex ante assumptions were applied in developing and measuring performance results in the Verification Report.⁵⁹ Energy Division reviewed parties' comments, and made changes in the 2008 DEER, with updated numbers where the comments were found to have merit. Energy Division conducted a workshop on September 16, 2009, to provide an opportunity for parties to ask questions about the methodologies used to prepare the Second Verification Report, and incorporated an appendix to the Report containing responses to comments from that workshop.

Energy Division thus followed established protocols for vetting that were found to be adequate in D.07-09-043, which we characterized as:

... a specific and adequate process by which parties can submit questions, concerns and comments to both Energy Division and evaluation contractors. Conferences and the submission of written comments based on conferences, allow parties to participate in the process by raising and discussing issues. This takes place in formulating the several reports before they are finalized: the draft Verification Report, the draft final evaluation reports, and the draft Final Performance

⁵⁸ See e.g., ALJ Ruling on process protocols dated January 11, 2006, in R.01-08-028 and January 2, 2007, in R.06-04-010.

⁵⁹ See e.g., Verification Report, Appendix Q for a compilation of such comments and responses.

Basis Report. Our belief is that any concerns the parties may have can be resolved through such a process.⁶⁰

Energy Division properly followed adopted procedures, thus providing stakeholders a fair opportunity to review and comment on the Report and its underlying assumptions. We acknowledged in D.08-12-059 the utilities'

... concerns expressed regarding the robustness of assumptions and updates thereof used to assess utility performance under the incentive mechanism. For example, the net-to-gross ratio has engendered substantial controversy throughout this proceeding. This can be largely attributed to the inherent difficulty in developing a robust number that quantifies the level of energy efficiency measure deployment that would have occurred in the absence of utility programs. Unlike many of the other parameters used in assessing program performance, which lend themselves to sampling methodologies and direct measurement, estimates of the net-to-gross ratio rely on surveys in which upstream and downstream program participants are asked to assess the impact of utility programs on their behavior or that of their customers.

In D.08-12-049, the Commission addressed this concern by no longer delegating authority to Energy Division to resolve disputes over the DEER values used in the Verification Reports independently from formal Commission authorization, stating that:

Beginning with the draft verification report that was issued on November 18, 2008 and going forward, we will require that Energy Division issue these reports via draft resolution for consideration and adoption by the Commission before those reports are used to determine incentive payments or penalties

⁶⁰ See D.07-09-043 at 129.

under the RRIM.⁶¹ This direction applies to both the verification reports used to assess interim claims as well as those used for the final true-up. These resolutions should include detailed information regarding the underlying assumptions used and supporting documentation that provides the basis for those assumptions. (D.08-12-049 at 21.)

The Commission formally adopted the Energy Division Second Verification Report by resolution on October 15, 2009. The resolution incorporated reference to Verification Report's extensive log of corrections made to modeling tools and inputs⁶² and its item-by-item responses to specific criticisms or comments posed by stakeholders.⁶³

While the utilities continue to disagree with various changes in the DEER and other measures that were implemented by Energy Division, disagreement does not demonstrate that the DEER parameters were not properly vetted. Moreover, the IOUs have failed to show that the figures underlying the Settlement or the SCE claim have been vetted or subjected to a degree of independent scrutiny approaching that of the Verification Report. We conclude that the methodologies and assumptions underlying the Verification Report offer the most reasonable basis for deriving interim incentives, particularly since the utilities will still be entitled to a final true-up payment next year.

In view of the asymmetry in risks and rewards facing the utility, relying on the Verification Report provides an appropriate balancing of goals and

⁶¹ D.08-12-049 directed Energy Division to issue its draft verification reports via resolution that could be adopted by the Commission in the same timeframe as envisioned in D.07-09-043 for the issuance of the final verification reports.

⁶² See Verification Report, Sec. 8.2.

⁶³ *Id.*, Sec. 9.2.

interests between investors and customers. The utilities' risk of *understated* incentive claims, at most, will be limited to any lost time value of money associated with additional 2006-2008 incentive earnings, if any, identified through the 2010 true-up. If the interim incentive payments were subsequently found to be understated, the utility would be made whole for the shortfall in the true-up.

On the other hand, if the interim incentive payment were to be based upon the Proposed Settlement, or upon SCE's self-reported RRIM earnings claims, the risk to ratepayers of overstated incentive payments would be much greater. In view of our adopted policy limiting any refunds for RRIM overpayments, the ratepayer would have little or no opportunity to be made whole if the 2010 true-up revealed that the final incentive awards were found to be less than the interim payments.

The Energy Division held multiple meetings with parties to review and discuss the 2008 DEER update process and results, and provided an opportunity for parties to give Energy Division written comments. Various parties provided written comments which were addressed in the Final Verification Report.

We disagree with SCE's claim that the Verification Report employed estimation and measurement techniques that went beyond acceptable EM&V protocols. The techniques utilized in the Verification Report were within the bounds of discretion allowed under those protocols. The Protocols are:

... not to be construed as limiting the ability of the CPUC or Joint Staff to evaluate items in addition to or beyond those identified in these Protocols. While these Protocols are the key guiding documents for the program evaluation efforts, the CPUC and the Joint Staff reserve the right to utilize additional methodologies or approach if they better meet the CPUC's evaluation objectives and when it serves to provide

reliable evaluation results using the most cost-efficient approaches available.⁶⁴

Even with the extensive process that has occurred, culminating in the adoption of the Verification Report by resolution, we recognize that the complexities, contentiousness, and level of detail inherent in the existing process for determining incentive awards may warrant a different approach to simplify the incentive process a going-forward basis. In the phase of this proceeding addressing forward-looking reforms, we intend to explore how to make the RRIM process more streamlined while preserving the underlying integrity of the incentive function. For purposes of the determination of any remaining RRIM earnings for the performance cycle that has already ended, however, we conclude that the fairest approach is to finish this cycle consistent with the basic expectations and protocols that guided utilities' performance during the 2006-2008 period.

As set forth in D.08-12-049, we took a step in reforming the process by requiring the issuance of a Commission resolution before the Verification Reports are used to assess interim claims. Shortly after issuance of D.08-12-049, however, we opened this rulemaking, with the goal of considering a new approach to determining remaining 2008 claims.

Although we adopted the requirement for approval of the Verification Report by Commission Resolution, we also anticipated the possibility of considering new ways to finalize the 2008 RRIM claims independently of the continuing disputes surrounding the Verification Report and DEER updates.

⁶⁴ See California Energy Efficiency Protocols, page 1, as quoted in the Verification Report at 100.

We also conclude that the Settlement's proposed disposition of the 2010 true-up process is not reasonable.

4.1. Treatment of Interactive Effects

Historically, the energy savings profile of a given efficiency measure has been considered in isolation. The impact of installing a single CFL, for instance, is estimated as the difference in its own energy consumption and that of the incandescent bulb it is assumed to replace. However, in some cases, measures have systems impacts, or "interactive effects," which are not captured by baseline comparisons along a single parameter. Some energy efficiency measures, for example, produce less heat than the measure they replace. Depending on factors, including where they are installed, certain energy efficiency measures may increase the need for heating or decrease the need for air conditioning.

The Energy Division reviewed available studies and revised DEER numbers to incorporate interactive effects for both residential and commercial measures for a number of lighting and appliance measures, resulting in negative therm impacts and positive kilowatt-hour (kW) demand impacts for select measures. The data underlying the Commission's currently adopted goals, however, do not reflect these assumptions regarding interactive effects.

For comparison, the Verification Report also showed the savings impacts assuming exclusion of all interactive effects, and inclusion of positive only interactive effects.

The Proposed Settlement calculates 2009 interim claims excluding the 2008 DEER updates relating to interactive effects (Settlement at page 9) that were not included in determining each utility's adopted savings goals. The Settlement thus (a) makes no adjustment for commercial positive interactive effects that

were in the original potential studies underlying the 2006-2008 goals, (b) excludes commercial negative interactive effects, and (c) excludes all residential positive or negative interactive effects.

The Settling Parties contend that it is appropriate to exclude interactive effects in calculating final achievements for 2006-2008 that were not accounted for in the 2005 DEER and in the potential studies used to determine the 2006-2008 savings goals.

PG&E disagrees with the Verification Report's inclusion of residential interactive effects in estimating unit energy savings. PG&E argues that this change in metric has not been vetted or approved, and was never considered in setting 2006-2008 goals or in program planning. PG&E believes that before making such a significant change, the simulation results upon which these changes are based must be thoroughly calibrated and evaluated using real-world measured data. Given the complexities involved, PG&E believes that modeling energy savings within an "average" home will likely produce inaccurate results.

DRA argues that there is no compelling reason to ignore interactive effects in calculating the 2009 interim claims, that ignoring their existence could overstate energy savings and undermine energy efficiency as a resource.

TURN disagrees with Settling Parties' assumption that because negative interactive effects were excluded in the potential studies underlying the 2006-2008 goals, such effects should be excluded from the 2009 claim. TURN contends there are numerous other additional positive savings opportunities not included in earlier potential studies that the IOUs have been able to pursue.

TURN argues that the DEER update's inclusion of interactive effects of heating merely quantifies an outcome that should be obvious. CFLs replace produce more heat than incandescent bulbs. All else being equal, if incandescent

bulbs are replaced with CFLs, the ambient room temperature will decrease. If the thermostat is set at a particular level in the room, the heater will run more often and longer to achieve the target temperature. TURN argues that it is wrong to treat the CFLs⁶⁵ as if they have no effect on heating levels, as proposed by the Settling Parties.

In D.09-05-037, we affirmed that interactive effects affect net energy savings and are thus appropriate for incorporation into the DEER update, stating that:

It is of paramount importance to maintain the analytical rigor of our methodologies to count savings. Compromising the technical integrity of our counting methodologies is tantamount to compromising the reliability of energy efficiency as a resource. Given the priority energy efficiency holds in our loading order, we are duly committed to reflecting our best knowledge regarding savings in DEER. (D.09-05-037 at 21.)

We also recognized, however, how interactive effects can have a significant effect on assumed savings achievement, particularly for the dual-fuel utilities, PG&E and SDG&E. Consequently, because interactive effects, particularly those experienced by dual-fuel gas and electric utilities, had not been considered in previously adopted energy efficiency goals, we found it reasonable

⁶⁵ While the discussion of negative interactive effects is focused on CFLs, other high efficiency lighting measures (such as high efficiency 4- and 8-foot linear fluorescent lamps, ballasts, fixtures, sensors, which are more prevalent in nonresidential installations) also work to reduce internal heat gain. With these measures, space cooling requirements are reduced and spacing heating requirements are increased. Also, other appliances and equipment such as refrigerators and freezers; stoves, ovens, and commercial dishwashing; motors; and commercial and industrial processing and manufacture, can reduce internal heat gain and thus contribute to varying levels of negative interactive effects.

in D.09-05-037 to make adjustments to SDG&E and PG&E's goals for therm savings for purposes of their 2009-2011 gross savings goals. Drawing from the Energy Division Verification Report's analysis of 2006-2007 data, we accordingly reduced the adopted 2009-2011 gross therm goals for PG&E by 26% and for SDG&E by 22%.

Therefore, while the Verification Report's recognition of interactive effects is consistent with the principles in D.09-05-037 upholding the importance of technical integrity in the counting of energy savings, it is reasonable to make a separate adjustment for interactive effects for purposes of awarding incentives. For purposes of evaluating goal achievement used to measure incentive awards, we agree that a reduction in the assumed therm savings goals is warranted to give some recognition to interactive effects. This adjustment in the goals has an effect on PG&E earnings, but does not change the earnings for the other utilities. Without any reduction in savings goals for interactive effects, the Energy Division Verification Report calculates that PG&E achieved 83% of its therm goals, thereby qualifying for incentive earnings. Based upon our exclusion of 2004-2005 data from the incentive calculation as discussed in Sec. 4.3 below, however, and with recognition of interactive effects, therm savings for PG&E would fall to 72%⁶⁶ which is below the 80% MPS necessary to qualify for incentive earnings. Consistent with the reduction in 2009-2011 therm goals, as adopted in D.09-05-037, we conclude that it is reasonable to make a reduction in 2006-2008 goals to recognize interactive effects that were not reflected in the originally adopted goals. We calculate that a reduction in therm goals of 11%

⁶⁶ See Appendix C, Table Es 2b.

would be sufficient to raise the MPS from 72% to 80% for therm savings for PG&E.

In D.09-05-037, we determined the adjustment that was appropriate to reduce 2009-2011 therm goals to recognize the applicable interactive effects, but we did not separately address in that proceeding how the utilities' therm goals for the 2006-2008 cycle should be adjusted for interactive effects. In comments on the proposed decision, PG&E argues that the same 26% reduction as was applied to reduce 2009-2011 therm goals in D.,09-05-037 should similarly be applied to reduce the 2006-2008 therm goals. We conclude that before deciding whether to apply the full 26% reduction to PG&E's 2006-2008 therm goals for purposes of computing RRIM earnings, parties should first have an opportunity to be heard on what specific adjustment would be appropriate for 2006-2008 therm goals to recognize interactive effects. We shall address this issue in the 2010 true-up. For purposes of the 2009 second interim installment as adopted in this decision, however, limiting the therm goal reduction to 11% provides a threshold level of earnings (at the 9% shared savings rate), while also protecting ratepayers from the potential for overpayment of RRIM earnings. Based on whatever adjustment to therm goals we determine is appropriate in the 2010 true-up, the utilities will still be made whole for any resulting effects on RRIM earnings.

In view of the reductions in prospective goals for interactive effects adopted in D.09-05-037, we consider an 11% reduction in 2006-2008 goals to be reasonable for our purposes here. We apply this 11% reduction in therm goals, which lifts PG&E from a 0% to a 9% earnings rate. When applied to the PEB, and

with the exclusion of 2004-2005 data as discussed below, the resulting interim incentive earnings for PG&E is as shown in Appendix A.⁶⁷

4.2. Effects of 2008 Codes and Standards Program

PG&E argues that the Verification Report should have included recognition of the effects on 2008 efficiency savings and earnings as a result of pre-2006 and post-2005 Codes and Standards advocacy work. PG&E specifically points to building standards effective October 2005 and appliance standards effective on or after January 2006. PG&E also argues that the PEB associated with Tier II lighting should be included in the RRIM calculation.

At the workshop held on September 16, 2009, Energy Division explained that this source of data was not updated in the interim report because the requisite updated information was not yet available, but that Energy Division would incorporate the updated information for 2008 in its final Performance Basis Report to be produced in 2010.⁶⁸ Accordingly, we find this explanation satisfactory for purposes of determining interim incentive earnings. Since the requisite data will be incorporated for purposes of the 2010 true-up, the utilities

⁶⁷ We adjust PG&E's therm goal from 44.8 MMtherms down 11% by multiplying $44.8 * (1-.11) = 39.9$. We adjust SDG&E's therm goal from 9.5 MMTherms down 11% by multiplying $9.5 * (1 - .11) = 8.5$.

For PG&E, the total achievements for 2006-2008 (including LIEE and C&S) is 32.2 therms, which is 81% of the revised therm goal of 39.9 therms. Consequently, PG&E's incentive earnings rate goes from 0% to 9%. But for SDG&E, their total therm achievement for 2006-2008 (including LIEE and C&S) is only 3.5 MMTherms. Even compared to a therm goal adjusted down 11%, SDGE is only making 47% of the therm goals. To be eligible for earnings, both the therm savings and GWh saving would have to be above 80% (GWh saving is at 74%).

⁶⁸ See Workshop Transcript at 177-178.

will be made whole for the effects of any updated data that may change the incentive earnings amount.

4.3. Exclusion of Cumulative 2004-2005 Goals for Incentive Earnings Purposes

The Energy Division Verification Report calculates savings based on cumulative results starting from 2004. This approach is based on the direction provided in D.07-09-043, Ordering Paragraph 4(b) which called for interim claims to be evaluated on a “cumulative-to-date” basis. As explained in D.07-10-037:

For any given year, cumulative savings represents the savings in that year from all previous measure installations (and reflecting any persistence decay that has occurred since the measures were installed) plus the first-year savings of the measures installed in that program year. (D. 07-10-037 at 77).

Our rules on cumulative savings goals were first developed in D.04-09-060 to ensure the Utilities focus on long-term savings, as opposed to those with short-term payback and short expected useful lives. We elaborated on this principle in D.07-10-037, which stated:

Under the risk/reward mechanism’s MPS, the utilities are further motivated to avoid excessive reliance on short-lived measures. Therefore, it does not work to the utilities’ advantage to focus exclusively on measures with short lives (or low persistence of savings over time) because doing so creates the savings shortfall illustrated above, making it harder to meet the MPS. For example, if an energy efficient light with an expected life of five years was installed in 2004, it will remain in service producing savings throughout 2006-2008, after which it will reach the end of its life and need to be replaced with like-savings in 2009. (D.07-10-037 at 77.)

The utilities, however, take issue with the Verification Report's inclusion of 2004-2005 data in measuring cumulative goals in deriving incentive earnings for the 2006-2008 cycle. PG&E notes that in D.09-05-037, the Commission found that 2004-2005 data is not directly reconcilable with 2006-2008 evaluation results. Consequently, cumulative savings for purposes of the prospective program cycle were defined to exclude the 2004-2005 data.

PG&E argues that the exclusion of 2004-2005 data from the RRIM calculations results in an earnings estimate that is nearly double that presented in the Verification Report. PG&E calculated that the effects of excluding 2004-2005 data from the cumulative goals increased the Verification Report RRIM earnings for PG&E. SCE similarly argues that the Verification Report misconstrues the MPS by including SCE 2004-2005 programs in its calculations of 2006-2008 interim earnings. NRDC likewise believes that the calculation of incentives for 2006-2008 should stand on its own, and not include cumulative energy efficiency activity dating back to 2004, as D.07-10-032 defined it.

For purposes of measuring interim incentive earnings for the 2006-2008 cycle, we agree that it is appropriate to exclude the effects of cumulative goals starting from 2004, as reflected in the Verification Report.

We recognize that based on more recent analysis in D.09-05-037, 2004-2005 data should be excluded from cumulative goals on a prospective basis. While D.09-05-037 has applicability for measuring cumulative savings goals on a forward-looking basis, similar principles apply to the savings goals used in determining 2006-2008 RRIM incentive earnings.

Therefore, we find that exclusion of the 2004-2005 goals in the calculation yields a more consistent metric for measuring incentive earnings. The effects on

the incentive earnings calculation resulting from exclusion of 2004-2005 goals are set forth in Appendix C of this decision.

As stated in D.09-05-037, however, we continue our commitment to the importance of cumulative goals which are a critical element of our overall strategy to create long-term, lasting savings through ratepayer investments. Without the cumulative savings goals, we are unable to ensure that energy efficiency programs will be comparable to investments in power plants.

4.4. Calculation of Shared Savings Rate

We have determined that ratepayer interests are best served by using updated assumptions and independently verified results to determine the amount of actual energy savings, and the value of those savings, to be shared between utilities and ratepayers. However, it is less clear that this is the appropriate means of comparing utility efforts with the Commission's goals in setting the shared savings rate. Those goals were established prior to the utilities carrying out their programs and prior to the updating of the assumptions at issue in this proceeding, and other than as proposed herein, those goals have not been revised to reflect updated information and assumptions.

Comparing utility results that reflect updated estimates and assumptions with Commission goals that do not reflect those same updates and assumptions appears to be an apples to oranges comparison. Since the Commission has not revisited and reset the goals to reflect updated information and assumptions, it is reasonable, for purposes of both this interim claim and the 2010 final true-up, to compare those goals with results that reflect the same underlying assumptions used in establishing those goals.

Each utility demonstrated in their proposals for earnings that using relatively unmodified ex ante assumptions to compare the results of their

programs with the Commission's goals would result in each utility meeting a high enough percentage of those goals to qualify for a 12% shared savings rate. The 12% shared savings rate was confirmed by Energy Division, which calculated the shared savings rate each utility would have received assuming certain key variables were not updated, consistent with the utility proposals. In Attachment A of ALJ Pulsifer's ruling issued on October 1, 2009, Energy Division provided the results of three different scenarios, including Scenario 2, that calculates the shared savings rate and associated incentives using Energy Division's verified installation rates as well as the Utilities' proposed assumptions that did not update key variables such as the net-to-gross ratio, expected useful life, interactive effects and the CFL residential/nonresidential split.⁶⁹

As shown Energy Division's Scenario 2, each of the utilities achieved a 12% shared savings rate using assumptions that did not update key variables. In contrast, using the Energy Division's Second Verification Report, even with the adjustments described above, results in significantly lower shared savings rates for PG&E, SCE, and SDG&E, 9%, 9%, and 0%, respectively. Rather than using the shared savings rate calculated using the verification report data, we will use a 12% shared savings rate and apply it to the PEB as calculated by the Energy Division Verification Report as modified herein.

5. Treatment of 2010 True-Up

The Proposed Settlement anticipates that the existing process for a true-up in 2010 would proceed forward. Settling Parties propose a schedule for the 2010

⁶⁹ ALJ Ruling Regarding Admission of Information Into the Record, October 1, 2009, Attachment A.

true-up process, as reproduced in Appendix B, for the 2010 true-up claim. In order to meet the goal of a Commission decision on the final 2010 true-up claim before the end of 2010, the Settling Parties propose that if the Energy Division's Final Verification and Performance Basis Report is not issued by April 15, 2010, then the 2010 claim would be calculated using the same inputs as for the 2009 claim. The Settling Parties' proposed process would require that Energy Division respond to discovery requests within five business days of receipt.

Also, if the Commission does issue a final decision on the true-up claims by September 15, 2010, then Settling Parties propose that the 2010 final RRIM claim would be calculated using the same assumptions used for the 2009 interim claim.

For the final 2006-2008 incentive claim, TURN believes that the Final Performance Basis Report, due in March 2010, should be used. Although TURN believes that the Commission can meet the deadline for disposing of final 2006-2008 claims by December 2010, TURN argues that the final claim must be based on the Energy Division ex post Report, under whatever schedule circumstances dictate.

DRA argues that the Proposed Settlement's mandatory April 15, 2010, deadline for Energy Division's Final Verification and Performance Basis Report would provide little incentive for the Utilities to cooperate with the process of preparing that report, but would encourage utility stalling to subvert the timely issuance of a Final Verification Report. DRA thus opposes the mandatory deadline for the Final Verification and Performance Basis Report, and advocates instead for active oversight of the Administrative Law Judge in ensuring that the process moves forward in a timely manner.

DRA argues that the Proposed Settlement's suggested five-day turn around for Energy Division to respond to data requests should only be considered if it is imposed on the Utilities as well. Based on past experience, DRA states that the utilities routinely take ten business days or more to respond to discovery requests.

5.1. Discussion

We find the 2010 true-up schedule in the Proposed Settlement creates an unfair outcome. The proposal is one-sided, focusing exclusively on potential adverse risks to investors as a result of delay in earnings, but ignores the potential adverse risks to ratepayers if incentive earnings claims are not subject to independent verification. The Settlement unjustifiably fails to acknowledge any responsibility on the part of the utilities to cooperate reasonably in making sure that deadlines are met. Allowing utilities to earn incentives without requiring *ex post* studies reflecting the net-to-gross ratio, EULs and interactive effects would reduce the risk for utilities, but increase risks to ratepayers of overpaying incentive awards.

We thus reject the conditions imposed in the Proposed Settlement for the 2010 true-up. The Proposed Settlement would eliminate the requirement that the final incentive payment be based upon verified performance through the true-up process. This proposal would undermine the integrity of the RRIM program, and make essential elements of the program dependent upon the uncertainties of a future schedule.

Accordingly, we adopt a schedule for the 2010 true-up, as set forth in Appendix B, but without the default condition in the Proposed Settlement that would dismantle the safeguards provided by the true-up. Under this schedule, parties shall have ample time and opportunity to identify and address issues

with the verification studies. As explained below, the principal adjustment we make to the Settlement's proposed schedule is to remove the allotted time for the so-called "Independent Reviewer." Eliminating this element of the schedule frees up additional time for other events in the schedule. While we expect all parties to cooperate in a timely manner in the exchange of information necessary to maintain the schedule, we reserve the option to adjust the schedule, as subsequent events may warrant. Our goal remains to conclude the true-up process in time to complete the authorization of final incentive awards before the end of 2010.

In comments on the proposed decision, TURN and DRA argue that the Energy Division should update the incremental cost data as part of the 2010 true-up. The protocols established in R.01-08-028 required Energy Division to verify the utility-reported estimates of incremental measure costs, that is, the difference between the standard measure and the efficient measure. As stated in the Second Interim Verification Report, the Energy Division did not update the incremental measure costs, but defaulted instead to the utility-reported values. TURN thus proposes that Energy Division be required to conduct a complete verification of the utility-reported incremental measure costs as part of the 2010 true-up. We agree that such verification should occur as part of the 2010 true-up in order to provide assurance that the final incentive earnings figures are accurate and reliable.

We also encourage parties to enter into further settlement discussions to seek agreement on a 2010 final true-up of incentive earnings for each utility that reasonably ties incentives to actual performance consistent with the policies adopted in this decision. We direct the parties to convene a settlement conference during the interval of time scheduled for data requests and

workshops (i.e., between March 17 and May 17, 2010) to seek agreement on the final 2010 true-up of incentives for each utility. Focusing on this timeframe will allow the settlement talks to progress informed by the preliminary findings of the Final Verification Report.

At the same time, while the Final Performance Basis Report may provide a context for settlement discussions, we encourage parties to explore the possibility of a 2010 true-up settlement based upon simplified assumptions or metrics not necessarily tied precisely to the detailed and minute level of calculations embodied in the Final Performance Basis Report for the 2006-2008 cycle. In this manner, the schedule for comments and adoption of the Final Performance Basis Report may proceed on a separate, but related track to the schedule for a settlement, or related dispute resolution processes to determine the final 2010 true-up of incentive amounts for each utility. While we reject the Proposed Settlement that has been offered to date, we continue to believe that a new settlement, formulated consistent with the policies adopted in this decision, can provide a path toward an expeditious 2010 true-up while minimizing potential controversy.

In the event parties are successful in reaching a full or partial settlement, they may jointly file a motion for a proposed settlement's adoption. In the event that parties do not reach full agreement, settlement discussions may still serve as a forum to narrow areas of dispute or to reach partial agreement covering certain metrics. In this manner, any remaining areas of dispute can be addressed in a focused manner, with the goal of a procedurally efficient resolution of disputes, leading to a timely decision on final true-up of incentive payments. As noted above, a settlement conference will take place during the time scheduled for data requests and workshops. After reviewing the evaluation reports, the Final

Performance Basis Report, and supporting documentation parties who wish to ask clarifying questions or request additional information from Energy Division may submit written requests to the Energy Division's Energy Efficiency Public Document website during the time for data requests and workshops in the schedule provided in Appendix B.

5.1.1. Proposal for Independent Reviewer

The Proposed Settlement also calls for an "Independent Reviewer, hired by the Commission and reporting to the ALJ" to review Energy Division's Final Verification and Performance Basis Report and ensure compliance with Commission direction and provide information to help the Commission resolve disputed issues.

Settling Parties argue that a significant roadblock experienced during 2008 was the controversy among parties on the appropriateness of certain conclusions reached in Energy Division's 2008 DEER Updates and the Draft Verification Report. The Settling Parties propose as a vehicle to address such controversy that an "Independent Reviewer" be designated to serve the ALJ and Commissioners in an advisory capacity to help resolve technical disputes. Rather than having the ALJ or Commissioners adopt a controversial technical finding based on the positions set forth by opposing experts, the Independent Reviewer would advise the ALJ or Commissioners on the relative merits of the technical arguments debate. The Independent Reviewer would examine the conclusions of the Final Performance Basis Report and the bases for all challenges. Based on that examination, the Independent Reviewer would summarize the disputes and provide an opinion and advice to the ALJ in resolution of the disputes using "the most accepted and reliable standards of review available." Settling Parties argue that the Independent Review is not

intended to take the place of Energy Division but rather to facilitate the resolution of disputed issues.

DRA believes that the Settlement's proposal for an "Independent Reviewer" is likely to add little value to the process. The Commission has already spent over 40% of the \$100 million budgeted for 2006-2008 EM&V activities. The Settling Parties, and SCE, do not like the results, so it is unclear what value another reviewer would add to justify the additional cost and time involved.

We reject the proposal for an independent reviewer. Such a proposal fundamentally undermines the integrity of the well-established processes already in place to support to the Commission's deliberative decision-making process. The notion of an "Independent Reviewer" is at best redundant and inefficient, and at worst, disruptive, undermining, and counterproductive to the role of the Commission's own staff of experts who are responsible for unbiased and independent EM&V work. Moreover, the selection process for an "Independent Reviewer" would potentially create its own new set of controversies over who should be selected, and how true "independence" and "competence" would be ascertained and/or subject to challenge. Current criticisms that the Energy Division findings are biased could simply be applied to the new "independent reviewer."

We previously considered and rejected the notion of an extraneous layer of outside review of Energy Division's EM&V work, as discussed in D.07-09-043:

... D.05-01-055 marked a shift in the responsibility for overseeing EM&V studies, from the utilities to Commission staff. The purpose of the shift was to help ensure unbiased results by having a neutral party overseeing the EM&V process. Commission staff provides a neutral, unbiased party

to facilitate parties' participation. In addition, Commission staff, specifically Energy Division, will have access to the experience and expertise of evaluation contractors throughout the processes for review and approval of both interim and final earnings claims.⁷⁰

Thus, as previously concluded in D.07-09-043, we again reject the proposal for a separate outside reviewer, finding that such a notion would serve no useful purpose, but would consume additional time and resources.

6. Assignment of Proceeding

John A. Bohn is the assigned Commissioner, and Thomas R. Pulsifer is the assigned ALJ for this proceeding.

7. Comments of Proposed Decision

The proposed alternate decision of the Commissioner in this matter was mailed to the parties in accordance with Section 311 of the Public Utilities Code and comments were allowed under Rule 14.3 of the Commission's Rules of Practice and Procedure. Comments were filed on December 7, 2009, and reply comments were filed on December 14, 2009. Based on these comments, we make two further adjustments to the verification report values. First, we are persuaded that it is appropriate to use for this interim evaluation a net-to-gross ratio of 75% for SCE's residential lighting system program. This change reflects SCE's specific approach in implementing this program, in particular a lower reliance on "big box" outlets.

The second change we make is to increase to 100% the realization rate assumed for SDG&E's Energy Savings BID program and SoCalGas' Local

⁷⁰ D.07-09-043 at 134

Business Energy Efficiency program. This change reflects the unique nature of these two programs, the utilities' on-site inspections and other features that result in a higher realization than standard statewide programs.

Findings of Fact

1. In September of 2007, by D.07-09-043, the Commission adopted the RRIM to encourage achievement of Commission-adopted energy efficiency goals, and to extend California's commitment to making energy efficiency the highest energy resource priority.

2. The RRIM adopted in D.07-09-043 was designed to rely upon independent verification of energy savings through production of Energy Division Verification Reports of utility energy efficiency costs and installations and services completed. These reports were to serve as the basis for interim and final incentive payments to utilities, as warranted.

3. The process established for the utilities to qualify for incentive earnings to meet and exceed Commission-adopted energy efficiency savings goals proved to be quite controversial, both because of delays and utility disputes about methodologies used by Energy Division in calculating interim incentive payments. These factors ultimately led to suspension of the schedule for review and approval of incentive payments for 2006-2008.

4. The Commission designated this proceeding as the forum to resolve outstanding disputes as to any remaining claims for 2006-2008 incentives.

5. Since the utilities have already received interim payments covering the 2006-2007 period, the Energy Division First Verification Report was deemed moot for the purposes of 2006- 2007 interim incentive payments.

6. Outstanding disputes relate to the manner in which interim incentive payments are computed and the transparency of the process for review and verification of data underlying incentive payment calculations.

7. Although the parties engaged in settlement talks on the disposition of outstanding disputes as to remaining 2006-2008 incentive claims, only a limited number of parties entered into a Settlement Agreement, which excluded disposition as to SCE's incentive claims.

8. Prior to reaching the compromises in the settlement, the Settling Parties advocated using the utility self-reported data for their quarterly reports to derive interim 2008 incentive payments.

9. The Proposed Settlement starts with the utilities' pre-settlement positions, incorporates the 2008 DEER updates for certain assumptions, with some exceptions, and holds back 35% of the interim claim for consideration in a true-up scheduled for 2010.

10. For 2009 interim claims, the Proposed Settlement excludes 2008 updates relating to: (1) net-to-gross ratios for measuring energy savings, (2) EULs of energy efficiency measures, and (3) interactive effects of different energy efficiency measures.

11. The Settlement applies different assumptions as compared with the Energy Division Verification Report as to the usage of CFLs split between residential and nonresidential customers, and different assumed in-service rates for CFLs.

12. The Settling Parties decline to base their incentive claims on 2008 updated estimates of net-to-gross ratios because such ratios are subjective and do not change the energy savings actually delivered by the utilities.

13. The Commission has previously required that the net-to-gross ratio was to be updated in the true-up process for purposes of determining final incentive payments.

14. The Verification Report relied upon available studies and other evidence to update EUL data relating to usage patterns for CFL lighting.

15. The settling parties decline to base their incentive claims on interactive effects in the 2008 DEER updates where those effects were not originally in the potential studies underlying the 2006-2008 goals.

16. The Settling Parties differ from the Energy Division Verification Report with respect to the usage of upstream lighting program CFLs split between residential and nonresidential customers, and in-service rates for CFLs because those measures are subject to ongoing studies that are not complete, but that are scheduled to be complete in time for the 2010 true-up.

17. The Settlement does not have the sponsorship of active parties that represent ratepayer interests.

18. The Settlement removes the requirement for utilizing 2008 ex ante updates for computing the second interim payment even though this requirement had been put in place to limit the risk of ratepayer overpayment of incentives.

19. Because the goals against which the utility energy efficiency programs are assessed are not adjusted based on updates to the ex ante assumptions, the assumptions underlying the goals are necessarily different than the assumptions underlying assessments of utility performance, which are updated. This gives rise to an “apples to oranges” comparison.

20. D.08-01-042 eliminated the provision for repayment of overcollection of incentive payments by true-up so that the incentive payments could be counted as regular earnings. The effectiveness of the incentive mechanism is seriously

undermined if the utilities cannot book authorized interim operating earnings under that incentive mechanism.

21. As noted in D.08-01-042, if the incentives are not booked at regular intervals, they would result in a one-time earnings adjustment that would likely be excluded from operating earnings, which are the basis for a company's financial valuation. The uncertainty could result in a higher cost of financing.

22. D.08-12-059 increased the holdback share from 35% to 65% to mitigate increased risks of overpayment associated with reliance on utility self-reported earnings claims.

23. Although updates to the DEER energy efficiency performance assumptions and supporting methodologies have continued to be the subject of controversy, stakeholders have been provided a reasonable opportunity to review and to be heard concerning those assumptions and their use in the Verification Report.

24. The Energy Division produced a second Verification Report, which was adopted by Commission resolution effective October 15, 2009, and which produced calculations of 2006-2008 incentive earnings based on independently verified utility performance.

25. The Verification Report produced calculations for a second installment of incentive earnings for each eligible utility. The specific amount of incentive earnings calculated is a function of assumptions made concerning the inclusion of 2004-2005 goals, and the treatment of interactive effects.

26. In D.09-05-037, the Commission determined that 2004-2005 data should be excluded from cumulative goals on a prospective basis for the 2009-2001 cycle. While D.09-05-037 has applicability for measuring cumulative savings goals on a

forward-looking basis, similar principles apply to the savings goals used in determining 2006-2008 RRIM incentive earnings.

27. In D.09-05-037, the Commission determined that a reduction in 2009-2011 therm goals was warranted to recognize interactive effects on energy efficiency measures for the dual-fuel utilities, PG&E and SDG&E.

28. Based upon similar principles that warranted a reduction in therm goals for the 2009-2011 program cycle, a related reduction in therm goals for PG&E and SDG&E is warranted for deriving 2006-2008 incentive earnings, to reflect the recognition of positive and negative interactive effects.

29. A reduction in therm goals by 11% to reflect interactive effects is sufficient to produce an MPS of 80% and thereby change the shared-savings percentage to 9%, instead of 0%, that would otherwise result in eliminating incentive earnings for PG&E.

30. Appendices C and D of this decision set forth the effects of excluding 2004-2005 data from the Commission-adopted goals in computing incentive earnings.

31. Using unmodified ex ante assumptions for purposes of comparing the utilities' results with the Commission goals and setting the shared savings rate yields a shared savings rate for each utility of 12%.

32. Consideration of the specific approach used by SCE to implement its residential lighting program suggests that an assumed net-to-gross ratio of 75% is appropriate for this program.

33. The unique nature of SDG&E's Energy Savings BID program and SoCalGas' Local Business Energy Efficiency program suggests that an assumed realization rate of 100% is appropriate for these programs rather than the realization rate derived for general statewide programs.

34. By adjusting the incentives earnings shown in the Verification Report (a) to exclude 2004-2005 cumulative savings goals, (b) to reduce gas therm savings goals by 11% for PG&E and SDG&E, respectively, (c) to use a 12% shared savings rate based on unmodified *ex ante* assumptions, (d) to use a 75% net-to-gross ratio for SCE's residential lighting program, and (e) to use a 100% realization rate for SDG&E's Energy Savings BID program and SoCalGas' Local Business Energy Efficiency program, the resulting incentives are derived as shown in Appendix A.

Conclusions of Law

1. The payment of the second installment of interim incentives for the 2006-2008 cycle should be determined based upon the figures set forth in Appendix A of this decision. These earnings balance the goals of fostering energy efficiency achievements while protecting ratepayers from paying for incentives that have not been earned.

2. Ratepayers' interests are protected when incentives are based upon independently reviewed and verified utility achievement of Commission-adopted energy efficiency goals.

3. The previously adopted program for awarding a second interim incentive payment this year to eligible utilities, with a final true-up adjustment in 2010, should be applied in implementing remaining incentive payments due for the 2006-2008 cycle.

4. The second installment of 2006-2008 interim incentives should be determined based upon the Energy Division's independent evaluation of performance results produced in the Energy Division's Second Verification Report, adjusted to exclude cumulative 2004-2005 goals, to reduce therm savings goals to reflect interactive effects that were not recognized in the original

potential studies underlying 2006-2008 goals, and to use a 12% shared savings rate based on a comparison of Commission goals with utility results assuming unmodified ex ante assumptions.

5. Although parties continue to object to many of the assumptions and methodologies contained in the Second Verification Report, parties were provided a reasonable opportunity to review the assumptions and methodologies and to be heard concerning objections through written comments and workshops.

6. The substantive adjustments in ex ante parameters made in the Second Verification Report are consistent with the adopted Protocols which give the Energy Division latitude, subject to Commission approval to determine the measurement of the respective parameters used to calculate incentive earnings.

7. Through the Resolution which adopted the Verification Report, and through the findings and conclusions set forth in this decision, the Commission has laid an appropriate basis for utilizing the Energy Division Second Verification Report in determining a second interim incentive payment.

8. The Proposed Settlement offered by parties is not reasonable in light of the record as a whole, and does not produce an equitable disposition of outstanding incentive payment claims.

9. The Proposed Settlement would partially reverse the ratepayer protections that were adopted in D.08-01-042. As a result, by not incorporating ex ante updates to key categories of parameters used to determine interim incentive payments, the Settlement does not offer incentive levels that preserve the requisite ratepayer protections.

10. The proposal of SCE for payment of 100% of its outstanding 2006-2008 incentive claims this year based on self-reported earnings without provision for a subsequent true-up or independent verification is not in the public interest.

11. The schedule for the 2010 true-up of final 2006-2008 incentive claims as set forth in Appendix B is reasonable and should be adopted subject to modification by the assigned Commissioner or assigned ALJ, if appropriate. While discipline should be applied to hold parties to the adopted schedule, subsequent modifications in the schedule may be considered for good cause. In any event, the provision for true-up should not be compromised in the event that the subsequent schedule is modified.

12. Further settlement discussions may provide a vehicle to reach consensus or narrow the areas of dispute concerning the calculation of a final true-up of incentive payments for the 2006-2008 cycle, if pursued in accordance with the principles set forth in this decision.

O R D E R

IT IS ORDERED that:

1. The energy efficiency Risk/Reward Incentive Mechanism awards set forth in Appendix A of this decision are hereby adopted as the second installment for calendar year 2009, covering the 2006-2008 program cycle, for Pacific Gas and Electric Company, Southern California Edison Company, San Diego Gas & Electric Company, and Southern California Gas Company.

2. Pacific Gas and Electric Company, Southern California Edison Company, and Southern California Gas Company are each authorized to file Tier 1 advice letters pursuant to General Order 96-B to implement the applicable tariff changes to collect the incentive earnings authorized by this decision.

3. The second installment of interim incentive earnings adopted in this decision shall reflect a 35% holdback of the total estimated to be earned, as set forth in Appendix A. Final incentive payments covering the 2006-2008 cycle, including disposition of the 35% holdback, shall be determined in accordance with the schedule set forth in Appendix B.

4. The schedule for determining the 2010 true-up of final incentive payments for the 2006-2008 cycle as set forth in Appendix B is hereby adopted, subject to modification by the assigned Commissioner or assigned Administrative Law Judge, if appropriate. The Settlement's proposal is rejected to utilize the same inputs for the true-up as used for interim incentive payments if the Verification Report is delayed for any reason.

5. Parties shall enter into settlement discussions to seek agreement, or narrow areas of difference, with respect to the final 2010 true-up of incentive payments for each utility. A settlement conference shall be scheduled to occur within 10 days after the Draft Energy Division Performance Basis Report is issued for comment.

6. Energy Division shall complete an independent verification of the utilities' self-reported incremental measure costs in conjunction with the scheduled final 2010 true-up of Risk/Reward Incentive Mechanism earnings for the 2006-2008 cycle.

7. The motion for adoption of the Proposed Settlement is hereby denied.

8. The proposal of Southern California Edison Company for an award of the full amount of its outstanding incentive claims for 2006-2008 without a subsequent true-up is hereby denied.

9. This proceeding remains open for consideration of prospective reforms to the Risk/Reward Incentive Mechanism in the next phase of this proceeding.

This order is effective today.

Dated December 17, 2009, at San Francisco, California.

MICHAEL R. PEEVEY
President
DIAN M. GRUENEICH
JOHN A. BOHN
RACHELLE B. CHONG
TIMOTHY ALAN SIMON
Commissioners

I reserve the right to file a concurrence.

/s/ DIAN M. GRUENEICH
Commissioner

Appendix A
Adopted Incentive Earnings for the
Second Installment of the 2006-2008 Program Cycle

Utility	From 1st Verification Report	Authorized in D.08-12-059 [A]	Earnings Rate	Max Earnings (PEB * Earnings Rate) [B]	Max Earnings less 35% holdback [C]	2nd Installment of Interim Earnings [C] - [A]	Holdback Amount Subject to Final True-up [B] - [C]
PGE	-	\$41,500,000	12%	\$115,277,868	\$74,930,614	\$33,430,614	\$40,347,254
SCE	-	\$24,700,000	12%	\$ 77,465,151	\$50,352,348	\$25,652,348	\$27,112,803
SDG&E-		\$10,800,000	12%	\$ 17,077,803	\$11,100,572	\$ 300,572	\$ 5,977,231
SCG	\$2,886,293	\$ 5,200,000	12%	\$ 11,247,724	\$ 7,311,021	\$ 2,111,021	\$ 3,936,703

The adopted incentive earnings figures are derived from the Energy Division Verification Report with both positive and negative interactive effects, but (a) excluding 2004-2005 cumulative goals, (b) with therm savings goals for PG&E and SDG&E reduced by 11% from the original levels, (c) using a 12% shared savings rate reflecting a comparison of Commission goals with utility results based on unmodified ex ante assumptions, (d) using a net-to-gross ratio of 75% for SCE's residential lighting program to reflect SCE's specific implementation approach to this program, and (e) using a realization rate of 100% for SDG&E's Energy Savings BID program and SoCalGas' Local Business Energy Efficiency program to reflect the unique nature of those programs as compared to more generic statewide programs. The reduction in saving goals for therms is made to recognize interactive effects that were not reflected in the original adopted goals.

(END OF APPENDIX A)

Appendix B
Adopted Schedule for 2010 RRIM True-up
For the 2006-2008 Program Cycle

Event	Proposed Per Settlement	Adopted
Draft of Resolution and Verification Report Issued	By April 15	April 15, 2010
Data Requests and Workshops	March 31 - May 17	April 17 - May 17
Settlement Conference	(not applicable)	By April 25
Opening Comments on Resolution	May 17	May 17
Reply Comments on Resolution	June 1	June 1
Energy Division Incorporates Revisions/ Responses into Report	(not mentioned)	June 15
Commission Resolution on Verification Report	(not applicable)	early July
Proposed Decision on Final 2006-2008 Incentives	July 15	July 15
Comments on PD	August 4	August 4
Reply Comments on PD	August 11	August 11
Final Decision on Commission Agenda	mid-September	mid-September

(END OF APPENDIX B)

Appendix C

Adjustment to Energy Division Second Verification Report Calculations To Exclude 2004-2005 Savings Goals for Energy Efficiency and LIEE Program

The results are summarized in the same format as from the executive summary of the Energy Division Verification Report (Tables ES 2 -a, b, c):

Table ES2a: GWh, MW, MMTherm Impacts with Positive Interactive Effects Only

	2nd Earnings Claim (PY2006-2008)				
	PG&E	SCE	SDGE	SoCalGas	Total
Savings Goals	PY 2006-2008				
Total Cumulative Savings (GWH)	2,826	3,135	850	0	6,811
Total Peak Savings (MW)	613	672	163	0	1,448
Total Cumulative Natural Gas Savings (MMTh)	45	0	10	57	112
Total Savings	PY 2006-2008				
Total Cumulative Savings (GWH)	3,141	2,747	625	0	6,513
Total Peak Savings (MW)	589	578	138	0	1,305
Total Cumulative Natural Gas Savings (MMTh)	56	0	7	57	120
MPS Individual Metric Performance					
Percent of Goal (GWH)	111%	88%	74%	0%	96%
Percent of Goal (MW)	96%	86%	85%	0%	90%
Percent of Goal (MMTh)	125%	0%	69%	100%	107%
MPS Average Metric Performance	111%	87%	76%	100%	98%

Table ES2b: GWh, MW, MMTherm Impacts with Positive and Negative Interactive Effects

	2nd Earnings Claim (PY2006-2007)				
	PG&E	SCE	SDGE	SoCalGas	Total
Savings Goals	PY 2006-2008				
Total Cumulative Savings (GWH)	2,826	3,135	850	0	6,811
Total Peak Savings (MW)	613	672	163	0	1,448
Total Cumulative Natural Gas Savings (MMTh)	45	0	10	57	112
Total Savings	PY 2006-2008				
Total Cumulative Savings (GWH)	3,141	2,747	625	0	6,513
Total Peak Savings (MW)	589	578	138	0	1,305
Total Cumulative Natural Gas Savings (MMTh)	32	0	4	57	93
MPS Individual Metric Performance					
Percent of Goal (GWH)	111%	88%	74%	0%	96%
Percent of Goal (MW)	96%	86%	85%	0%	90%
Percent of Goal (MMTh)	72%	0%	37%	100%	83%
MPS Average Metric Performance	93%	87%	65%	100%	90%

Table ES2c: GWh, MW, MMTherm Impacts without Interactive Effects

	2nd Earnings Claim (PY2006-2007)				
	PG&E	SCE	SDGE	SoCalGas	Total
Savings Goals	PY 2006-2008				
Total Cumulative Savings (GWH)	2,826	3,135	850	0	6,811
Total Peak Savings (MW)	613	672	163	0	1,448
Total Cumulative Natural Gas Savings (MMTh)	45	0	10	57	112
Total Savings	PY 2006-2008				
Total Cumulative Savings (GWH)	3,042	2,640	600	0	6,282
Total Peak Savings (MW)	517	506	124	0	1,146
Total Cumulative Natural Gas Savings (MMTh)	56	0	7	57	120

MPS Individual Metric Performance					
Percent of Goal (GWH)	108%	84%	71%	0%	92%
Percent of Goal (MW)	84%	75%	76%	0%	79%
Percent of Goal (MMTh)	125%	0%	69%	100%	107%
MPS Average Metric Performance					
	106%	80%	72%	100%	93%

With the removal of 2004-2005 goals, PG&E's therm goals for 2006-2008, including both positive and negative interactive effects, would be reduced to 44.8 million therms. By comparison, PG&E's actual 2006-2008 therm savings equals 32.2 million therms, consisting of:

EE Savings= 26 million therms
 C&S Savings = 1.9 million therms
 LIEE Savings = 3.8 million therms
 TOTAL = 32.2 million therms

The 32.2 million therms is only 72% of the 44.8 million therm goal. Since the 72% MPS would be below 80%, PG&E would not be eligible for incentive earnings under the "Positive-and-Negative-Interactive-Effects" Scenario, assuming no adjustment in gas therm savings goals.

(END OF APPENDIX C)

Appendix D

Effects on Energy Division Verification Report Incentive Earnings Calculations To Exclude 2004-2005 Savings Goals for Energy Efficiency and LIEE Program

Without Interactive Effects

Second Verification Report							
Utility	From 1st Verification Report	Authorized in D.08-12-059 [A]	Earnings Rate	Max Earnings (PEB * Earnings Rate) [B]	Max Earnings less 35% holdback [C]	2nd Interim Earnings [C] - [A]	Holdback Amount Subject to Final True-up [B] - [C]
PG&E	-	\$41,500,000	9%	\$92,298,941	\$59,994,312	\$18,494,312	\$32,304,629
SCE	-	\$24,700,000	0%	-	-	-	-
SDG&E	-	\$10,800,000	0%	-	-	-	-
SCG	\$2,886,293	\$ 5,200,000	12%	\$9,832,762	\$6,391,296	-	\$3,441,467

With Positive-Only Interactive Effects

Second Verification Report							
Utility	From 1st Verification Report	Authorized in D.08-12-059 [A]	Earnings Rate	Max Earnings (PEB * Earnings Rate) [B]	Max Earnings less 35% holdback [C]	2nd Interim Earnings [C] - [A]	Holdback Amount Subject to Final True-up [B] - [C]
PG&E	-	\$41,500,000	12%	\$127,387,255	\$82,801,716	\$41,301,716	\$4,585,539
SCE	-	\$24,700,000	9%	\$60,543,730	\$39,353,425	\$14,653,425	\$21,190,306
SDG&E	-	\$10,800,000	0%	-	-	-	-
SCG	\$2,886,293	\$5,200,000	12%	\$9,832,762	\$6,391,296	-	\$3,441,467

With Both Positive and Negative
Interactive Effects

Utility	From 1st Verification Report	Authorized in D.08-12-059 [A]	Earnings Rate	Second Verification Report			Holdback Amount Subject to Final True-up [B] - [C]
				Max Earnings (PEB * Earnings Rate) [B]	Max Earnings less 35% holdback [C]	2nd Interim Earnings [C] - [A]	
PGE	-	\$41,500,000	0%	-	-	-	-
SCE	-	\$24,700,000	9%	\$53,183,505	\$34,569,278	\$9,869,278	\$18,614,227
SDG&E	-	\$10,800,000	0%	-	-	-	-
SCG	\$2,886,293	\$5,200,000	12%	\$9,832,762	\$6,391,296	-	\$3,441,467

PG&E's incentive earnings would drop to zero in the "Both Positive and Negative Interactive Effects" since the MPS for gas therms would decline below 80% (see Appendix C, Table ES2b), resulting in a zero earnings rate. The scenarios labeled "With Positive-Only" and "Without Interactive Effects" have earnings rates of 12% and 9% respectively.

(END OF APPENDIX D)